2002

Daniel K. Dygert and Stephanie C. Dygert v. Alan M. Collier and Mike Youngberg : Brief of Appellant

Utah Court of Appeals

Robert W. Hughes; Counsel for Appellees.
Marty E. Moore; Bearnson & Peck; Counsel for Appellants.

Case No. 20020878

IN THE

UTAH COURT OF APPEALS

DANIEL K. DYGERT and **STEPHANIE C. DYGERT,**

Plaintiffs and Appellants

v.

ALAN M. COLLIER and **MIKE YOUNGBERG,**

Defendants and Appellees

BRIEF OF APPELLANTS

Appeal from the Second District Court, Davis County
The Honorable Glen R. Dawson

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LIST OF ALL PARTIES BELOW

Plaintiffs: Daniel K. Dygert
Stephanie C. Dygert

Defendants: Chicago Title Insurance Company
Bonneville Title Company, Inc.
Clearwater Oaks, L.C.
Alan M. Collier
Mike Youngberg

CITATIONS TO RECORD

Citations to the record on appeal will be designated in parenthesis as RA followed by the page number(s) assigned by the clerk of court below in the judgment roll and index, e.g., (RA 103) designates record on appeal page 103.

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JURISDICTION OF THE COURT OF APPEALS

By order, this matter was transferred from the Supreme Court to the Court of Appeals. (RA 813). The Court of Appeals has jurisdiction of this appeal pursuant to Utah Code Ann. § 78-2a-3(2)(j), which provides in pertinent part:

> 78-2a-3. Court of Appeals jurisdiction
> (2) The Court of Appeals has appellate jurisdiction, including jurisdiction of interlocutory appeals, over:
> . . . .
> (j) cases transferred to the Court of Appeals from the Supreme Court.

ISSUES PRESENTED FOR REVIEW AND STANDARD OF REVIEW

Issue No. 1

APPELLEES THEMSELVES COMMITTED TORTIOUS ACTS BY AFFIRMATIVELY MISREPRESENTING AND CONCEALING INFORMATION ABOUT A MATERIAL DEFECT IN RESIDENTIAL REAL PROPERTY FROM THE DYGERTS, WHO WERE PURCHASING THE PROPERTY. IN DOING SO, APPELLEES ACTED AS REPRESENTATIVES OF A LIMITED LIABILITY COMPANY IN WHICH THEY WERE THE ONLY TWO MEMBERS. DID APPELLEES OWE A LEGAL DUTY TO THE DYGERTS SUCH THAT APPELLEES ARE INDIVIDUALLY LIABLE FOR THEIR OWN TORTIOUS CONDUCT?

Issue No. 2

A TITLE COMPANY CONSPIRED WITH APPELLEES TO "INSURE OVER" A BILLBOARD SIGN LEASE ENCUMBERING RESIDENTIAL REAL PROPERTY BEING SOLD TO THE DYGERTS, MEANING THE LEASE WOULD NOT BE DISCLOSED IN TITLE REPORTS. IN RELIANCE UPON APPELLEES' AFFIRMATIVE MISSTATEMENTS AND TITLE REPORTS REGARDING THE PROPERTY, THE DYGERTS DID NOT PERSONALLY SEARCH TITLE RECORDS. WERE THE DYGERTS LEGALLY REQUIRED TO SEARCH TITLE RECORDS OR DID THEY JUSTIFIABLY RELY ON APPELLEES' AFFIRMATIVE MISSTATEMENTS AND TITLE REPORTS?

Standard of Review

This is an appeal from an order granting summary judgment and dismissing Plaintiffs'/Appellants' ("the Dygerts") *Amended Complaint* against Defendants/Appellees Alan M. Collier and Mike Youngberg ("Appellees"). The appropriate standard of review for both issues is set forth in *WebBank v. American General Annuity Service Corp.*, 54 P.3d 1139, 1143 (UT 2002):

> A trial court may properly grant summary judgment when "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." Utah R. Civ. P. 56(c); see also *Holmes Dev., LLC v. Cook*, 2002 UT 38, ¶ 21, 48 P.3d 895; *Ault v. Holden*, 2002 UT 33, ¶ 15, 44 P.3d 781; *State ex rel. Div. of Forestry, Fire & State Lands v. Tooele County*, 2002 UT 8, ¶ 8, 44 P.3d 680. The propriety of a trial court's grant of summary judgment is a question of law. *Holmes Dev.*, 2002 UT 38 at ¶ 21. In deciding whether summary judgment was appropriate, we need review only whether the trial court erred in applying the relevant law and whether a material fact was in dispute. *Id.*; *Hill v. Allred*, 2001 UT 16, ¶ 12, 28 P.3d 1271. "We thus review the trial court's legal conclusions for correctness, according them no deference." *Holmes Dev.*, 2002 UT 38 at ¶ 21; *see also Ault*, 2002 UT 33 at ¶ 15.

Citation to Record

Both issues were addressed in the trial court in Appellees' pleadings entitled *Defendants, Alan M. Collier and Mike Youngberg's, Motion for Summary Judgment and Supporting Memorandum* (RA 197-340); *Defendant Alan M. Collier and Mike Youngberg's Reply to Opposition to Motion for Summary Judgment* (RA 447-460); *Memorandum in Support of Defendants, Alan M. Collier and Mike Youngberg's Motion for Summary Judgment or for Judgment on the Pleadings* (RA 566-580); *Defendants*

Alan M. Collier and Mike Youngberg's Reply to Plaintiffs' Opposition to Motion for Summary Judgment (RA 658-668). In addition, both issues were addressed in the trial court in the Dygerts' pleadings entitled *Memorandum in Opposition to Defendants Alan M. Collier's and Mike Youngberg's Motion for Summary Judgment* (RA 374-424); *Memorandum in Opposition to Defendants Alan M. Collier's and Mike Youngberg's Motion for Summary Judgment or for Judgment on the Pleadings* (RA 583-647); and *Notice of Filing of Supplemental Authorities Regarding Plaintiffs' Memorandum in Opposition to Defendants Alan M. Collier's and Mike Youngberg's Motion for Summary Judgment or for Judgment on the Pleadings,* which included a law journal article on the issue of personal liability of corporate officers and directors (RA 648-655).

CITATION OF LEGAL AUTHORITIES

The following statutory provisions in Utah Code Annotated are of importance in this appeal:

> **16-10a-622 Liability of shareholders.**
> (1) A purchaser from a corporation of shares issued by the corporation is not liable to the corporation or its creditors with respect to the shares except to pay or provide the consideration for which the issuance of the shares was authorized under Section 16-10a-621 or specified in the subscription agreement under Section 16-10a-620.
> (2) Unless otherwise provided in the articles of incorporation, a shareholder or subscriber for shares of a corporation is not personally liable for the acts or debts of the corporation solely by reason of the ownership of the corporation's shares.
>
> **48-2c-104 Separate legal entity**. A company formed under this chapter is a legal entity distinct from its members.
>
> **48-2c-116 Member or manager as a party to proceedings**. A member or manager of a company is not a proper party to proceedings by or against a company, except when the object is to enforce a member's or manager's right against, or liability to, the company.
>
> **48-2c-601 General rule**. Except as provided in Section 48-2c-602, no organizer, member, manager, or employee of a company is personally liable under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the company or for the acts or omissions of the company or of any other organizer, member, manager, or employee of the company.
>
> **57-3-102 Record imparts notice --Change in interest rate --Validity of document --Notice of unnamed interests --Conveyance by grantee.**
> (1) Each document executed, acknowledged, and certified, in the manner prescribed by this title, each original document or certified copy of a document complying with Section 57-4a-3, whether or not acknowledged, each copy of a notice of location complying with Section 40-1-4, and each financing statement complying with Section 70A-9a-502, whether or not acknowledged shall, from the time of recording with the appropriate county recorder, impart notice to all persons of their contents.

(2) If a recorded document was given as security, a change in the interest rate in accordance with the terms of an agreement pertaining to the underlying secured obligation does not affect the notice or alter the priority of the document provided under Subsection (1).

(3) This section does not affect the validity of a document with respect to the parties to the document and all other persons who have notice of the document.

(4) The fact that a recorded document recites only a nominal consideration, names the grantee as trustee, or otherwise purports to be in trust without naming beneficiaries or stating the terms of the trust does not charge any third person with notice of any interest of the grantor or of the interest of any other person not named in the document.

(5) The grantee in a recorded document may convey the interest granted to him free and clear of all claims not disclosed in the document in which he appears as grantee or in any other document recorded in accordance with this title that sets forth the names of the beneficiaries, specifies the interest claimed, and describes the real property subject to the interest.

68-3-1 Common law adopted. The common law of England so far as it was not repugnant to, or in conflict with, the constitution or laws of the United States, or the constitution or laws of this state, and so far only as it is consistent with and adapted to the natural and physical conditions of this state and the necessities of the people hereof, is hereby adopted, and shall be the rule of decision in all courts of this state.

STATEMENT OF THE CASE

The Dygerts appeal from a final *Order* dated October 9, 2002 issued by the Second District Court, the Honorable Glen R. Dawson, granting Appellees' motion for summary judgment and dismissing the Dygerts' *Amended Complaint* against Appellees. (RA 758, 759). The appeal is taken from the entire *Order* as well as *Findings of Fact and Conclusions of Law* issued by the Second District Court, the Honorable Glen R. Dawson, on the 9th day of October, 2002, and incorporated by reference into the final *Order*. (RA 752-755).

The Dygerts commenced the action below by filing a *Complaint* in June 2001 against the following defendants: Chicago Title Insurance Company, Bonneville Title Company, Inc., Clearwater Oaks, L.C., Alan M. Collier and Mike Youngberg. (RA 4-20). The *Complaint* set forth six claims: 1) fraud and misrepresentation (against all defendants); 2) conspiracy to defraud (against all defendants); 3) negligent misrepresentation (against all defendants); 4) breach of contract (against Defendant Clearwater Oaks, L.C.); 5) breach of warranty (against Defendant Clearwater Oaks, L.C.); and 6) constructive trust (against Defendants Collier and Youngberg). (RA 4-20).

After answers were filed by all the defendants and discovery begun, the trial court granted the Dygerts leave to amend their original *Complaint*. (RA 363-364). The Dygerts then filed their *Amended Complaint* (RA 344-362), and Appellees filed their *Answer to Amended Complaint* (RA 425-434).

Appellees first sought summary judgment under Rule 56, U.R.Civ.P., by filing a document entitled *Defendants, Alan M. Collier and Mike Youngberg's, Motion for Summary Judgment and Supporting Memorandum* (RA 197-340), on the grounds that they cannot be held personally liable for their individual acts committed on behalf of their limited liability company ("LLC"). Included in the many exhibits attached to Appellees' first summary judgment motion was a complete copy *of Plaintiffs' Responses to Defendant Clearwater Oaks, L.C., Alan M. Collier, and Mike Youngberg's First Set of Interrogatories, Requests for Admissions, and Requests for Production of Documents to Plaintiffs* (RA 313-329), in which the Dygerts set forth, under oath, the basis for their claims against Appellees.

The Dygerts responded to Appellee's first motion for summary judgment by filing their *Memorandum in Opposition to Defendants Alan M. Collier's and Mike Youngberg's Motion for Summary Judgment* (RA 374-424), in which the Dygerts set forth facts supported by an affidavit, deposition transcripts, discovery responses and other documents. These facts supported the allegations against Appellees set forth in the Dygerts' *Amended Complaint* (RA 344-362). Appellees then filed their *Notice to Submit for Decision* (RA 435-436), and the trial court issued its *Minute Entry Ruling* (RA 439), stating that:

> [I]t is the opinion of this Court that there are genuine issues of material fact in existence in this matter which prevent the granting of summary judgment in any of the areas submitted by counsel. Accordingly, the motion for summary judgment is denied.

Appellees next filed a document entitled *Motion for Reconsideration* (RA 445-446) and another entitled *Defendants Alan M. Collier and Mike Youngberg's Reply to Opposition to Motion for Summary Judgment.* (RA 447-460). In their reply memorandum, Appellees did not dispute any of the Dygerts' statement of additional facts in a manner contemplated by Rule 56, U.R.Civ.P., that is, by affidavit, deposition transcript or other method. *Id.* Rather, Appellees reiterated their claims that it was Clearwater Oaks, L.C. ("Clearwater Oaks") – Appellees' limited liability company – that committed the tortious acts alleged in the *Amended Complaint. Id.* Appellees thus asserted:

> The acts complained of by the Plaintiffs are clearly the acts of the owner of the property which was the LLC. Accordingly, as a matter of law, the individual Defendants are not and cannot be personally liable for the acts alleged in Plaintiff's (sic) Amended Complaint.

(RA 449).

In response, the Dygerts filed a document entitled *Plaintiffs' Response to Defendants Collier and Youngberg's Motion for Reconsideration* (RA 461-463) in which the Dygerts did not object to the Court considering Appellees' reply memorandum. However, the Dygerts did note that Appellees' reply memorandum was "replete with factual disputes." (RA 462). The court below then heard oral argument on *Appellees' Motion for Reconsideration* and denied the motion. (RA 563). The Court's ruling was memorialized in the *Order Denying Defendants Alan M. Collier and Mike Youngberg's Motion for Summary Judgment.* (RA 669-670).

Appellees then made their third attempt at summary judgment, filing a document entitled *Memorandum in Support of Defendants, Alan M. Collier and Mike Youngberg's Motion for Summary Judgment or for Judgment on the Pleadings*. (RA 566-580). For this third attempt at summary judgment, however, Appellees did not file a new motion seeking such relief as required by CJA 4-501. Nor did Appellees' memorandum include any exhibits. *Id.* Instead, Appellees re-argued their previous position that they could not be held personally liable for the acts of their limited liability company, Clearwater Oaks, L.C. (RA 567-569, 578-579), then raised new issues. Appellees' assertions were summarized in the conclusion to their memorandum, which stated:

> Even if the individual defendants had participated in some wrongful act or omission, which is denied, the Plaintiffs' causes of action based upon fraud and/or misrepresentation must be dismissed against them personally because, as a matter of law, neither of the individual defendants had a duty to the Plaintiffs. Further, the Plaintiffs cannot meet the requirement that their reliance on the statement or omission of the individual defendants was justifiable. Plaintiffs could [not] justifiably rely on the nondisclosure of a Lease, which Lease was a public record. Further, Plaintiffs also had "inquiry notice" of the Lease by reason of the indication on the plat map referencing the lease. Defendant Clearwater Oaks, the owner and seller of the property, may have had a duty, if one existed, but not the individual defendants personally.

(RA 579).

The Dygerts responded with their *Memorandum in Opposition to Defendants Alan M. Collier's and Mike Youngberg's Motion for Summary Judgment or for Judgment on the Pleadings*. (RA 583-647). In this memorandum in opposition, the Dygerts again set

forth numerous facts supporting their claims in their *Amended Complaint* against Appellees and included supporting exhibits as required by Rule 56, U.R.Civ.P. (RA 583-647). This memorandum in opposition highlighted certain of Appellees' individual tortious actions, noted disputes over material facts and addressed the legal issues raised by Appellees in their memorandum. (RA 584-601).

Shortly thereafter, the Dygerts also filed a document entitled *Notice of Filing of Supplemental Authorities Regarding Plaintiffs' Memorandum in Opposition to Defendants Alan M. Collier's and Mike Youngberg's Motion for Summary Judgment or for Judgment on the Pleadings.* (RA 648-655). Attached to the notice was an article entitled *Personal Liability of Corporate Officers* that had just been published in the June 2002 edition of "The Defense" magazine. (RA 650-655).

Appellees filed their reply memorandum entitled *Defendants Alan M. Collier and Mike Youngberg's Reply Memorandum to Plaintiffs' Opposition to Motion for Summary Judgment.* (RA 658-668).

On August 20, 2002, the trial court held a hearing on the third round of memoranda regarding Appellees' efforts to obtain summary judgment or dismissal. (RA 690). At the conclusion of the hearing, the court took the matter under advisement and scheduled a telephonic hearing on September 17, 2002 for the purpose of announcing its ruling. *Id.* On September 17, 2002, the trial court rendered its decision (RA 751), as set forth in its *Order* (RA 758-759) and *Findings of Fact and Conclusions of Law* (RA 752-

755), both of which are dated October 9, 2002 and were filed October 10, 2002. The Dygerts timely filed their *Notice of Appeal* on October 18, 2002. (RA 760).

All other defendants in this action have been dismissed by order of the trial court upon stipulation of the parties. (RA 365-366, 437-438, 749-750, 756, 757). Therefore, the October 9, 2002 *Order* of the trial court is a final order.

STATEMENT OF THE FACTS[1]

Appellees are developers who in 1997 organized Clearwater Oaks, L.C. ("Clearwater Oaks") for the purpose of purchasing and developing real property. (RA 197, 198). Appellees were the only members of Clearwater Oaks. (RA 224, 230-233). In 1997 Clearwater Oaks bought lots in a subdivision adjoining the west side of the I-15 corridor in West Bountiful. (RA 347, 389). Shortly after the purchase, Appellees and Clearwater Oaks entered into a dispute with the billboard sign company that held leasehold rights to construct and maintain billboard signs on the lots Appellees had purchased. (RA 347, 395, 398-400, 407, 408, 410, 411, 414-417).

This dispute over the billboard sign lease lasted from 1998 until early 2000, when a lawsuit between Clearwater Oaks and the billboard sign company was settled. *Id.* Clearwater Oaks commenced its lawsuit against the billboard sign company before the Dygerts contracted to purchase their property, and the lawsuit continued until shortly after the Dygerts closed on the purchase of their property in December 1999. (RA 347, 395, 407, 411, 414-417). **Appellees knew that the billboard sign lease encumbered**

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[1] The facts set forth in the Statement of Facts are drawn from the pleadings, portions of depositions on file, responses to discovery requests on file, affidavits and other exhibits submitted with memoranda supporting and opposing Appellees' motions for summary judgment. *See Surety Underwriters v. E&C Trucking, Inc.*, 10 P.3d 338, 339 (UT 2000)("summary judgment is appropriate only 'if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.'")

the residential real property purchased by the Dygerts, yet they never once told the Dygerts about the lease encumbrance on the property. (RA 395, 408, 414-417, 608-610). Nor did the title company or real estate agent involved notify the Dygerts of the existence of the billboard sign lease. (RA 610).

The Dygerts have alleged and are prepared to prove that Appellees were aware in 1999 that disclosure of the billboard sign lease encumbrance to the Dygerts, as prospective buyers, would likely have caused the Dygerts to back out of their purchase of a home and lot. (RA 348, 349). Approximately a year before the Dygerts contracted to purchase Lot 2, the purchasers of adjoining Lot 1, Wayne and Amy Clausing ("the Clausings"), walked out of their real estate closing transaction with Clearwater Oaks when they learned that the billboard sign lease encumbered that lot. (RA 323, 324, 348, 411, 628). The Clausings did not purchase Lot 1 until they were assured that the billboard sign lease had been removed from that property. *Id.*

The Dygerts contracted to purchase their property – Lot 2 – from Clearwater Oaks on May 17, 1999 – after Clearwater Oaks had filed its lawsuit against the billboard sign company. (RA 199, 398, 402). Appellee Youngberg signed the contract documents as a representative of Clearwater Oaks. (RA 199, 301-310).

Before contracting, Appellee Youngberg provided the Dygerts with a copy of a plat map purporting to show easements of record affecting Lot 2. (RA 377, 378, 389, 603). The plat map showed that the billboard sign lease only encumbered a portion of

another lot in the subdivision – Lot 5 – which is where a billboard sign is conspicuously located. (RA 389). **When Appellee Youngberg showed the misleading plat map to the Dygerts, Appellees knew that the plat map was incorrect and that the billboard sign lease, in fact, encumbered Lot 2, which the Dygerts ultimately purchased.** (RA 319, 408, 411, 628).

At the time of contracting on May 17, 1999, **Appellee Youngberg also provided the Dygerts with a form real estate document entitled "Seller's Property Condition Disclosure (Land)," in which he affirmatively misrepresented that: 1) there was no ongoing litigation affecting Lot 2; 2) there were no undisclosed easements affecting Lot 2; and 3) there was nothing that should be disclosed that materially or adversely affected the value of Lot 2.** (RA 391, 392, 605-606).

At the time of contracting, the Dygerts requested that they be provided with a report on the status of title of Lot 2. (RA 612). Shortly thereafter, Appellees, through their realtor, provided the Dygerts with a preliminary title report from Bonneville Title Company, Inc. ("Bonneville") that purposefully did not disclose the billboard sign lease as an encumbrance on Lot 2. (RA 319, 320, 348, 610). All title reports, title insurance commitments and title insurance policies provided thereafter to the Dygerts by Appellees or Bonneville failed to disclose the billboard sign lease as an encumbrance on Lot 2. (RA 610).

The Dygerts have alleged and are prepared to prove at trial that, because litigation had not removed the billboard sign lease as an encumbrance, Appellees decided to go forward with sales of lots encumbered by the billboard sign lease, anyway. (RA 319, 348). The Dygerts have alleged and are further prepared to prove that Appellees thus agreed with Bonneville that Bonneville would "insure over" or "insure around" the sign lease. (RA 319, 320, 348). This means that the billboard sign lease would not be disclosed in Bonneville's title reports, title insurance commitments or title insurance policies as either an encumbrance affecting Clearwater Oaks' lots in the subdivision or as an exception to title insurance policies. *Id.* Consequently, the preliminary title reports, title insurance commitments and title insurance policy issued to the Dygerts did not disclose the existence of the billboard sign lease. (RA 319, 320, 348, 350, 610).

The Dygerts have alleged and are prepared to prove that both Appellees were aware of Bonneville's decision to "insure over" the billboard sign lease before the Dygerts contracted to purchase Lot 2 on May 17, 2001. (RA 319, 320, 348-350, 421-424). However, Appellees did not inform the Dygerts that Bonneville was "insuring over" the lease. (RA 349, 395, 610). Rather, Appellees and Bonneville affirmatively endeavored to conceal the existence of the billboard sign lease from the Dygerts. (RA 319, 320, 348-350, 407, 408, 610).

The Dygerts closed on Lot 2 on December 21, 1999. (RA 346). Appellee Collier signed the Warranty Deed on behalf of Clearwater Oaks, transferring ownership of Lot 2

to the Dygerts that same day. (RA 330). Less than a month later, the lawsuit between Clearwater Oaks and the billboard sign company was settled. (RA 395, 407, 416, 417, 624-628). As part of that settlement, Appellee Collier, on behalf of Clearwater Oaks, signed and caused to be recorded a document entitled "*Acknowledgment of Lease*," which states that the lease "is in full force and effect according to its terms," except that the billboard sign company waived its right of first refusal to purchase the affected lots. (RA 402, 416, 417, 619). Nevertheless, the Dygerts were never told that Appellee Collier had signed and recorded a document that re-affirmed the validity of the billboard sign lease as an encumbrance to the Dygerts' property. (RA 395). Nor did Appellees request or obtain the Dygerts' permission to execute and record the "*Acknowledgment of Lease.*" (RA 395, 410, 627).

When Appellee Collier executed and caused to be recorded the "*Acknowledgment of Lease*" in January 2000, neither Appellees nor their LLC, Clearwater Oaks, possessed a legal interest in Lot 2. (RA 395, 402, 410, 627).

A year and a half after purchasing their home and lot from Appellees' LLC, the Dygerts attempted to sell their property to Jeff and Jennifer Mabey ("the Mabeys"). On May 17, 2001, the Dygerts had executed all documents necessary to close on that sale and the Mabeys were executing their documents when the billboard sign lease was disclosed to the Mabeys by the title officer at the closing. (RA 321, 346). The Mabeys refused to close and their lender refused to lend on the purchase of the home and lot until

the billboard sign lease was terminated as to that property. (RA 321, 346, 347, 394, 395, 609). **May 17, 2001 was the first time the Dygerts learned of the existence of the billboard sign lease as an encumbrance to their property**. (RA 395, 610). The Dygerts were unable to have the billboard sign lease terminated as to Lot 2 in time to consummate their sale to the Mabeys, and they have suffered damages as a result. (RA 344-362).

In their *Amended Complaint*, the Dygerts sued Appellees, as individuals, for: 1) fraud and misrepresentation; 2) conspiracy to defraud; 3) negligent misrepresentation; 4) constructive trust; and 5) fraudulent misrepresentation. *Id.* All of these claims were dismissed by the court below on summary judgment. (RA 758-759).

SUMMARY OF ARGUMENTS

First Argument

The trial court erred by concluding as a matter of law that Appellees cannot be held liable for tortious acts they themselves committed on behalf of their limited liability company ("LLC"). Because Appellees individually and actively participated in the commission of torts that injured the Dygerts, each Appellee is personally liable to the Dygerts for the injuries caused thereby.[2]

Second Argument

The trial court erred by concluding as a matter of law that Appellees did not personally owe a legal duty to the Dygerts. Under agency law, Appellees had a legal duty not to injure the Dygerts in a residential real estate transaction in which Appellees were acting on behalf of their own LLC.[3] As members and agents of the LLC selling real property to the Dygerts, Appellees had a common law duty to refrain from acts that were reasonably risky to the Dygerts – even if those acts served the interests of the LLC.[4] As members and agents of the LLC, Appellees had a duty to disclose a known material defect in the property.[5] Finally, as real estate developers and agents of the LLC,

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[2] 18B Am. Jur. 2d Corporations § 1877; *Pentecost v. M.W. Harward*, 699 P.2d 696 (UT 1985); *Kaumans v. White Star Gas & Oil Co., et al*, 63 P.2d 231(UT 1936).

[3] *Pentecost v. M.W. Harward*, 699 P.2d 696 (UT 1985); *Kaumans v. White Star Gas & Oil Co., et al*, 63 P.2d 231(UT 1936).

[4] *PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368 (Cal.App.2d 2000).

[5] *Hermansen v. Tasulis*, 48 P.3d 235 (UT 2002).

Appellees owed the Dygerts a duty to supply correct information about the property being sold.[6] Each of these duties is a legal duty that both Appellees owed to the Dygerts.

Third Argument

The trial court erred by concluding as a matter of law that, since the billboard sign lease was a matter of public record, the Dygerts could not justifiably rely on Appellees' representations about the state of title to the residential real property they had contracted to purchase. Appellees affirmatively misrepresented and concealed material information about a material defect in the real property, i.e., the existence of a billboard sign lease that encumbered the property. Accordingly, the Dygerts were legally justified in relying upon Appellees' representations of the status of title to that property[7] – especially given that the Appellees' representations were corroborated by title reports provided by the title company that had conspired with Appellees to conceal the existence of the billboard sign lease. The Dygerts did not have a legal duty to independently search title records to determine whether the information Appellees provided them was correct. *Id.* In addition, justifiable reliance is generally a jury issue.[8]

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[6] *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302 (UT 1983).

[7] *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302 (UT 1983); *Dugan v. Jones*, 615 P.2d 1239 (UT 1980).

[8] *Robinson v. Tripco Investments*, Inc., 21 P.3d 219 (UT App. 2000).

ARGUMENT

On Appellees' third attempt at summary judgment or dismissal of the Dygerts' claims against them, the trial court accepted three of Appellees' legal assertions. First, the trial court accepted Appellees' contention that Appellees themselves could not be held personally liable for their own conduct committed on behalf of Clearwater Oaks, their LLC. (RA 754; Addendum A-17). Second, the trial court accepted Appellees' contention that Appellees did not owe a legal duty to the Dygerts because Appellees were acting on behalf of their LLC. *Id.* Third, the trial court accepted Appellees' contention that the Dygerts could not justifiably rely upon Appellees' representations about the state of title of the residential real property the Dygerts had contracted to purchase from them. *Id.*

These issues will be addressed in order below.

I. Appellees Are Personally Liable for Their Own Tortious Acts Committed on Behalf of Their LLC.

Tort Law

The Dygerts did not sue Appellees for acts committed by others on behalf of Clearwater Oaks. Nor are the Dygerts seeking to "pierce the corporate veil" or to hold Appellees responsible for the debts or obligations of Appellees' LLC, Clearwater Oaks. Rather, the Dygerts sued Appellees for the tortious acts that Appellees themselves committed. (RA 344-362). The Dygerts' tort claims against Appellees are based on the straightforward application of long-standing principles of tort law.

Throughout the proceedings below, Appellees sought refuge in the Utah Revised Limited Liability Company Act, Utah Code Ann. § 48-2c-101 *et seq*, from personal liability for their own wrongful conduct. (RA 200, 201, 452, 569). Appellees repeatedly cited Utah Code Ann. §§ 48-2c-104, 48-2c-116 and 48-2c-601 in support of their argument that they could not be held individually liable for the acts or obligations of their LLC. *Id.* Although this argument ultimately gained favor with the court below, it completely missed the point of the Dygerts' claims against Appellees. "**The legal fiction of the corporation as an independent entity was never intended to insulate officers and directors from liability for their own tortious conduct.**"[9]

The personal liability of corporate officers and directors – and members or managers of an LLC – for their individual wrongdoing committed on behalf of a business entity is clear. In *Reedeker v. Salisbury*, 952 P.2d 577, 582 (UT App. 1998), this Court acknowledged the general rule that "**[a] director is not personally liable for his corporation's contractual breaches unless he assumed personal liability, acted in bad faith or committed a tort in connection with the performance of the contract.**" *(emphasis added.)* Stated differently, *Reedeker* recognizes a tort law exception to the general rule of business-entity law that officers and directors are not liable for debts and obligations of the company.

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[9] *See PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368, 1380 (Cal.App.2d 2000)(*emphasis added*).

The instant case involves application of the tort law exception to the general rule of limited liability for business entities, that is, imposing personal liability when a principal of a business entity himself commits a tort on behalf of the entity. This exception is best explained in 18B Am. Jur. 2d Corporations § 1877[10], which states that an **officer or director:**

> **is not liable for torts committed by or for the corporation unless he has participated in the wrong**. Accordingly, directors not parties to a wrongful act on the part of other directors are not liable therefore. **If, however, a director or officer commits or participates in the commission of a tort, whether or not it is also by or for the corporation, he is liable to third persons injured thereby**, and it does not matter what liability attaches to the corporation for the tort. **A contrary rule would enable a director or officer of a corporation to perpetrate flagrant injuries and escape liability behind the shield of his representative character, even though the corporation might be insolvent or irresponsible.** . . Participation may be found not solely on the basis of direct action but may also consist of knowing approval or ratification of unlawful acts.
>
> . . .
>
> **That a corporate officer is acting for the corporation or within the scope of his employment when he participated in the company's commission of a tort does not affect his liability for the tort.**
>
> . . .
>
> The liability of a director or corporate officer as a participant in a tort is distinct from the liability resulting from the "piercing of the corporate veil." The effect of piercing a corporate veil is to hold the owner liable, the rationale for doing so being that the corporation is something less than a bona fide independent entity. **On the other hand, a director or officer who is liable as a participant in a tort**

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[10] 18B Am. Jur. 2d Corporations § 1877 is reproduced in its entirety in the Addendum to this brief at pages A-8 to A-12.

> **is liable as an actor rather than as an owner.** His liability is in no way dependent on a finding that the corporation is inadequately capitalized, that the corporation is a mere alter ego of himself, that the corporate form is being used to perpetrate a fraud, or that corporate formalities have not been properly complied with -- the absence of such findings does not affect the director's or officer's liability. (*citations omitted*)(*emphasis added*).

This exception to the general rule governing liability of officers and directors appears to be universally accepted in American jurisdictions that have addressed the issue. The above-quoted passage from Am.Jur.2d cites 54 cases in support and none opposed. (Addendum A-2 to A-6). In addition, before the hearing on Appellees' third attempt at summary judgment, the Dygerts provided the trial court with supplemental authorities in the form of an article entitled "*Personal Liability of Corporate Officers*" that had just been published in the June 2002 edition of "For The Defense" magazine.[11] **This article cites more than 25 cases around the country supporting the common law axiom that corporate officers and directors are liable for their own tortious conduct, regardless whether the wrongful conduct was committed on behalf of a business entity**. Again, no contrary cases are cited in the article. **After a national search of relevant jurisprudence, we have not discovered a single case supporting Appellees' assertion that a member of an LLC <u>is not</u> personally liable for his own tortious conduct committed on behalf of the LLC.**

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[11] The article entitled "*Personal Liability of Corporate Officers*" published in the June 2002 edition of "For The Defense" magazine is reproduced in the Addendum to this brief at pages A-13 to A-18.

Admittedly the instant case deals with an LLC, not a corporation. However, the statutory limitation of liability for members of an LLC under Utah Code Ann.§ 48-2c-601 is similar in scope to the limitation of liability for shareholders of a corporation provided in Utah Code Ann. § 16-10a-622 and for partners in a limited liability partnership provided in Utah Code Ann. § 48-1-12 (2).

Therefore, the same basic principles should apply. Above all else is the principle of limited liability, which, for LLC's, is codified in Utah Code Ann. §§ 48-2c-104 ("A company formed under this chapter is a legal entity distinct from its members."), 48-2c-116 ("A member or manager of a company is not a proper party to proceedings by or against a company.") and 48-2c-601, which provides:

> Except as provided in Section 48-2c-602, no organizer, member, manager, or employee of a company is personally liable under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the company or for the acts or omissions of the company or of any other organizer, member, manager, or employee of the company.

The common law of tort unambiguously imposes personal liability on corporate officers and directors for their own wrongdoing. Therefore, the question now before this Court is whether the Utah Revised Limited Liability Act, Utah Code Ann. § 48-2c-101, *et seq.*, establishes different liability standards for members of LLC's.

Utah Code Ann. § 48-2c-601 is key to answering that question. The operative language of section 601 reads: "no member . . . is personally liable . . . for a debt, obligation, or liability of the company or for the acts or omissions of the company or of

any other organizer, member, manager, or employee of the company." (*Emphasis added*). **The meaning of section 601 is plain: A member is not personally liable for the acts of any other person on behalf of the LLC. Section 601, however, does nothing to alter or limit a member's common law liability under tort or agency law for the member's own tortious acts.** Therefore the common law prevails,[12] and members of LLC's are just as personally liable for their own wrongful acts as officers and directors are for theirs. Simply put, a tortfeasor is a tortfeasor wherever he may be found.

This position is supported by commentators who have reviewed LLC enabling statutes around the country. *See* "*Those Delaware LLCS–Another Look How They Could Work For You*," Frederic J. Bendremer,10 -JUN Bus.L.Today 43, 45 (The protections against personal liability conferred by the act are not necessarily absolute. . . . **Personal liability may also result from certain types of tortious or otherwise wrongful conduct**.")(*emphasis added*); "*Limited Liability Companies: Issues In Member Liability*," Karin Schwindt, 44 UCLA L.Rev. 1541, 1548 ("Regardless of one's status as a member of an LLC, that member cannot escape liability for her personal misconduct. The most obvious example is the commission of a tort. According to well-established tort law principles, **'[a] tort is no less a tort for being committed in the service of a separate legal person.' If a member commits a tort while in the course of LLC business, she may be held personally liable for that tort.**")(*emphasis added*); "*Tax-*

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[12] *See* Utah Code Ann. § 68-3-1

Advantaged Securities Handbook, Chapter 12A. The Limited Liability Company," Robert J. Haft and Peter M. Fass, 2 Tax Adv. Sec. Handbook § 12A:7, 2002 ("**A member or manager is liable, however, for his own acts or omissions, including liability for a crime, a tort, or a breach of contract undertaken in his own right.**")(*emphasis added*); N.J. Forms Legal & Bus. § 18A:3, 2002 ("**However, inherent in the concept of limited liability is the fact that members and managers, employees and agents, are not insulated from liability resulting from their own wrongdoings, such as tort or professional malpractice.**")(*emphasis added*); "*Asset Protection: Domestic and International Law And Tactics, Chapter 18 Limited Liability Companies*," Duncan E. Osborne and Elizabeth Morgan Shurig, 2 Asset Protection: Dom. & Int'l L. & Tactics § 18:08, 2002 ("**In addition, criminal and other statutes, as well as common law principles, may impose liability on a member or manager who commits a crime, tort, or other violation while acting on behalf of a limited liability company.**")(*emphasis added*).[13]

Of course, the commentators are right. "A contrary rule would enable a [member] of a [limited liability company] to perpetrate flagrant injuries and escape liability behind the shield of his representative character, even though the [limited liability company]

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[13] *See also Ingalls v. Standard Gypsum, L.L.C.*, 70 S.W. 3d 252 (Tex.App.– San Antonio, 2001)(Genuine issue of material fact as to whether member of LLC had committed an independent tort precluded summary judgment for member in negligence action brought by injured employee of LLC.).

might be insolvent or irresponsible."[14]

Agency Law

The Dygerts' case is also governed by long-standing principles of agency law. In *Pentecost v. M.W. Harward*, 699 P.2d 696, 699 (UT 1985), the Utah Supreme Court stated:

> If an agent commits a tort while acting on behalf of his principal, the fact that he is an agent does not insulate him from liability to the injured party. **The agent's liability is determined solely upon the common-law obligation that every person must so act or use that which he controls as not to injure another.... [W]hether he is acting on his own behalf or for another, an agent who violates a duty which he owes to a third person is answerable to the injured party for the consequences.** It is no excuse to an agent that his principal is also liable for a tort.... Nor is an agent who is guilty of tortious conduct relieved from liability merely because he acted at the request, or even at the command or direction, of the principal, unless he is exercising a privilege of the principal to commit the act. 3 Am.Jur.2d Agency § 300 (1962)(*footnotes omitted*)(*emphasis added*).

Nearly fifty years before *Pentecost*, the Supreme Court had recognized that "**the agent is responsible to third persons when he is negligent in the performance of the duties which he undertakes**, whether such act be termed misfeasance or nonfeasance."[15]

Tort and Agency Law

More than twenty years ago, the United States District Court for the Northern

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[14] 18B Am. Jur. 2d Corporations § 1877, *supra*; Addendum pages A-2 to A-6.

[15] *Kaumans v. White Star Gas & Oil Co., et al*, 63 P.2d 231, 238 (UT 1936)(*emphasis added*).

District of California[16] recognized that principals of business entities have personal liability under both tort and agency law theories:

> Basic principles of tort and agency law provide the starting point for defining those circumstances. An agent "who does an act otherwise a tort is not relieved from liability by the fact that he acted at the command of the principal or on account of the principal." **Applied to corporations, this rule of agency law means that "(a)n officer or director is, in general, personally liable for all torts which he authorizes or directs or in which he participates, notwithstanding that he acted as an agent of the corporation and not on his own behalf."** Courts have, however, consistently stated that a corporate executive will not be held vicariously liable, merely by virtue of his office, for the torts of his corporation. **Personal liability must be founded upon specific acts by the individual director or officer.** (*citations omitted*)(*emphasis added*)

Under the rules of tort and agency, Appellees would be liable to the Dygerts if a jury finds that Appellees committed the tortious acts alleged in the Dygerts' *Amended Complaint.* As the only two members of their LLC, Appellees effectively stood in the position of officers and directors of that business entity. And, as noted above, members of an LLC are just as liable under tort law for their own misdeeds as are corporate officers and directors. Therefore, the principles of officer and director liability set forth in 18B Am. Jur. 2d Corporations § 1877, *supra*, apply to Appellees.

In addition, Appellees were acting as members and agents of their LLC in their interactions with, and conduct toward, the Dygerts. As agents of the LLC, Appellees are

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[16]*Murphey Tugboat Co., Ltd. v. Shipowners & Merchants Towboat Co., Ltd*, 467 F.Supp. 841, 850 (N.D. Cal. 1979), *aff'd* 658 F.2d 1256, 1257 (9th Cir. 1981), *cert. denied*, 455 U.S. 1018, 102 S.Ct. 1713 (1982).

subject to the venerable principles of agency liability set forth in *Pentecost v. M.W. Harward*, 699 P.2d 696 (UT 1985) and *Kaumans v. White Star Gas & Oil Co., et al*, 63 P.2d 231(UT 1936).

In reviewing the rulings of the court below, this Court must consider the facts and inferences therefrom in a light most favorable to the Dygerts.[17] In their *Amended Complaint*, memoranda and exhibits submitted to the court below, the Dygerts have alleged and are prepared to prove at trial that:

- Appellees personally knew the billboard sign lease encumbered Lot 2 before and after the Dygerts purchased the property (RA 347, 408, 414-417);
- Appellees personally knew that disclosure of the lease to the Dygerts would likely cause the Dygerts to refuse to close on their purchase of Lot 2, as the Clausings had done a year earlier (RA 323, 324, 348, 411);
- Appellees personally knew that their LLC had filed a lawsuit against the billboard sign company before the Dygerts contracted to purchase Lot 2 and that the lawsuit continued until after the Dygerts closed on the purchase of the property (RA 348, 349, 395, 407, 411, 414-417);
- Appellees personally knew that the billboard sign lease was a material

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[17] *Low v. City of Monticello*, 54 P.3d 1153, 1157 (UT 2002)("Additionally, when reviewing a grant of summary judgment, " 'we view the facts and all reasonable inferences drawn therefrom in the light most favorable to the nonmoving party.' ")

defect – "something which a buyer or seller of ordinary intelligence and prudence would think to be of some importance in determining whether to buy or sell."[18] – affecting Lot 2 before and after the Dygerts contracted to purchase their property (RA 323, 324, 348);

- Appellees personally conspired among themselves and with Bonneville to conceal information about the billboard sign lease (RA 348, 349, 352-355);
- Appellees personally knew that Bonneville had agreed to "insure over" the lease encumbrance to Lot 2 and therefore would issue preliminary title reports and title commitments that did not disclose the existence of the billboard sign lease (*Id.*);
- Appellees personally knew that Bonneville Title Company would issue a title insurance policy that did not list the billboard sign lease as an exception to the policy (RA 348, 349);
- Appellee Youngberg intentionally provided the Dygerts a copy of a plat map showing that the billboard sign lease only encumbered Lot 5, where the billboard is conspicuously located, when Appellee Youngberg knew that the lease also encumbered Lot 2 (RA 319, 377, 378, 389, 408, 411);
- At the time of contracting, Appellee Youngberg completed, signed and provided the Dygerts with a completed form document entitled *"Seller's*

[18] *Hermansen v. Tasulis*, 48 P.3d 235, 242 (UT 2002).

Property Condition Disclosure (Land)," in which he affirmatively misrepresented that there was no ongoing litigation affecting Lot 2, that there were no undisclosed easements affecting Lot 2, and that there was nothing that should be disclosed that materially or adversely affected the value of Lot 2 (RA 391, 392);

- Appellees, at the Dygerts' request and through their realtor, provided the Dygerts with a preliminary title report from Bonneville that purposefully did not disclose the billboard sign lease as an encumbrance on Lot 2 (RA 608-610);
- Appellees never told the Dygerts about the billboard sign lease affecting Lot 2 or the litigation over the billboard sign lease as it affected Lot 2 before or after the Dygerts purchased Lot 2 (RA 395);
- On December 21, 1999, Appellee Collier signed a Warranty Deed conveying Lot 2 to the Dygerts (RA 330);
- In January 2000, Appellee Collier, without the Dygerts' knowledge and consent, signed and caused to be filed an "Acknowledgment of Lease" that re-affirmed the validity of the billboard sign lease as an encumbrance to Lot 2 (RA 395, 402, 410, 416, 417);
- In May 2001, the Dygerts sale of their property (Lot 2 and a house) failed when the buyers learned at closing of the existence of the billboard sign

lease and walked out of the closing transaction (RA 321, 346, 347, 394, 395);

- In May 2001, the buyers' lender refused to lend on the sale of the Dygerts' property until the billboard sign lease was terminated as an encumbrance on that property (RA 395); and
- The Dygerts have been injured and their injuries were proximately caused by Appellees' tortious conduct (RA 344-362).

Therefore, the trial court erred by concluding as a matter of law that Appellees could not be held liable to the Dygerts for acts Appellees' committed on behalf of their LLC, Clearwater Oaks.

II. Appellees Individually Owed Multiple Duties to the Dygerts, Including: 1) A Duty Not to Injure; 2) A Duty to Refrain from Acts that Were Reasonably Risky; 3) A Duty to Disclose a Material Defect; and 4) A Duty to Supply Correct Information.

Duty Not To Injure

As set forth above, the Utah Supreme Court has recognized the common law duty of an agent to a third party with whom the agent transacts on behalf of a principal.[19]

Duty To Refrain From Risky Acts

Other courts have gone a step further, specifically addressing the duty a principal of a business entity owes to persons with whom the principal deals on behalf of the

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[19] *Pentecost v. M.W. Harward*, 699 P.2d 696 (UT 1985); *Kaumans v. White Star Gas & Oil Co., et al*, 63 P.2d 231, 238 (UT 1936).

entity. For example, the California Second District Court of Appeals in *PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368, 1381 (2000), stated:

> **A corporate officer or director, like any other person, owes a duty to refrain from injuring others.** In the context of a negligence claim, the Supreme Court has held that, like any other person, "directors individually owe a duty of care, independent of the corporate entity's own duty, to refrain from acting in a manner that creates an unreasonable risk of personal injury to third parties." . . . Stated differently, the Supreme Court held: "**Like any other citizen, corporate officers have a societal duty to refrain from acts that are reasonably risky to third persons even when their shareholders or creditors would agree that such conduct serves the institution's best interests.** (*emphasis added; citations omitted*)

Duty to Disclose Known Material Defects

In Utah "sellers of real property owe a duty to disclose material known defects that cannot be discovered by a reasonable inspection by an ordinary prudent buyer."[20] Appellees, however, chose to do just the opposite. Behind the shield of their LLC, they made affirmatively misleading statements to, and concealed material information from, the Dygerts about the existence of the billboard sign lease.

Duty to Supply Correct Information

Appellees are real estate developers who owed the Dygerts a distinct duty to supply correct information about Lot 2. *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302 (UT 1983). In *Christenson*, the Supreme Court recognized

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[20] *Hermansen v. Tasulis*, 48 P.3d 235, 241 (UT 2002), citing *Mitchell v. Christensen*, 31 P.3d 572.

that a person who is involved in a real estate transaction – but not as a party – may have a duty to supply accurate information to the buyer even though the person is not in privity with the buyer, stating: "If, however, 'the information is given in the capacity of one in the business of supplying such information, that care and diligence should be exercised which is compatible with the particular business or profession involved.'" *Id.* at 305.

In the instant case, Appellees are developers who deal in the business of developing and selling real property. Because they sold real estate to the Dygerts through their LLC, Appellees were not individually in privity with the Dygerts in the transaction. Nevertheless, because of their superior position as developers with specialized knowledge about real estate transactions, Appellees owed the Dygerts "the duty of care to insure the accuracy and validity of the information" they provided the Dygerts. *Id.*

The court below erred by concluding as a matter of law that Appellees did not personally owe a duty to the Dygerts.

III. The Dygerts Justifiably Relied Upon Appellees Misrepresentations About The True State Of Title To The Property They Were Purchasing.

The law in Utah is crystal clear on this issue. A buyer may justifiably rely on a seller's statements about the true state of title to real property because a buyer has no duty to examine official title records in the recorder's office to determine whether the seller's

representations are true.[21] In *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302, 307 (UT 1983), the Supreme Court held:

> Generally a failure to examine public records does not defeat an action for a false representation because in most cases there is no duty to make such an examination. 37 Am.Jur.2d Fraud and Deceit § 263 (1968). Thus, it has been held in fraud cases that a plaintiff who contracts to buy property is under no duty to examine public records to ascertain the true state of title claimed by the seller.

Moreover, a buyer has no duty to look behind the seller's statements about real property when the buyer has no indication there is a problem with the seller's representations about the property.[22] Likewise, a buyer is not barred from recovering from the seller on a fraud claim simply because the buyer had the opportunity to investigate the truth of the seller's representations and chose not to.[23] As long as the Dygerts did not undertake to independently search the title records on Lot 2 before their purchase, they could rely on Appellees' representations.[24]

The Dygerts have alleged and are prepared to prove that Appellees affirmatively misrepresented and concealed the true state of title of Lot 2. First, Appellee Youngberg

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[21] *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302 (UT 1983).

[22] *Dugan v. Jones*, 615 P.2d 1239, 1246 (UT 1980)("[A] vendee of real property, in the absence of facts putting him on notice, has no duty to investigate to determine whether the vendor has misrepresented the area conveyed.").

[23] *Id.* ("Nor is a vendee estopped from recovering in an action for deceit because he had the opportunity to inspect or otherwise check the property prior to purchase.").

[24] *Id.*

provided the Dygerts with a copy of a plat map showing a cross-hatched portion of Lot 5, indicating that the billboard sign lease only affected that lot. The Dygerts are prepared to prove that, at the time he showed the Dygerts the misleading plat map, Appellee Youngberg personally knew that the billboard sign lease affected all the lots his LLC was attempting to sell, including Lot 2.

Then, at the time of contracting (May 17, 1999), Appellee Youngberg provided the Dygerts with a form real estate document entitled "Seller's Property Condition Disclosure (Land)" in which he affirmatively misrepresented that there was no ongoing litigation affecting Lot 2, that there were no undisclosed easements affecting Lot 2, and that there was nothing that should be disclosed that materially or adversely affected the value of Lot 2.

Also at the time of contracting, the Dygerts requested that they be provided with a preliminary title report, showing the status of title for Lot 2. Appellees knew that Bonneville would issue a title report, but the title report would conceal the existence of the billboard sign lease. Approximately a week after they made their request for such a report, the Dygerts were provided a preliminary title report by Clearwater Oaks' realtor. Neither that report nor any other title report, title commitment or title insurance policy thereafter provided to the Dygerts revealed the existence of the billboard sign lease as a material encumbrance on Lot 2.

The Dygerts did not independently search title records or retain a qualified person

to search title records to determine whether the information provided by Appellees was correct. They were under no duty to do so.[25] Together, *Christenson* and *Dugan* stand for the proposition that a buyer of real property does not have legal duty to ferret out fraud when such buyer has no notice or other indication of potentially fraudulent activity by the seller. A buyer may reasonably rely on the representations of the seller.

There is great wisdom in the common law. The pure *caveat emptor* approach espoused by Appellees, and accepted by the court below, would wreak havoc on real estate transactions in this state. Prudent buyers, looking for fraud in every transaction, would not be able to accept as true any information provided by sellers. A prudent buyer, to protect herself from defects in title, would not be able to rely upon title reports prepared by a title company like the Dygerts did. Instead, she would be forced to hire a lawyer to issue a title opinion. Many of the standard practices we take for granted in real property transactions in Utah would end, making such deals more difficult and expensive.

Constructive Notice Not Applicable

The trial court's ruling that the Dygerts cannot demonstrate justifiable reliance suggests that the court believed the Dygerts were on constructive notice about the fraudulent nature of Appellees' actions merely because the billboard sign lease was

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[25] *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302, (UT 1983) and *Dugan v. Jones*, 615 P.2d 1239 (UT 1980).

recorded. But the fact that an instrument regarding an interest in real property is recorded is not, by itself, sufficient to put a party on notice of fraudulent conduct. In *Baldwin v. Burton*, 850 P.2d 1188, 1195 (UT 1993), the Supreme Court stated:

> 'Mere constructive notice of the deed by reason of its being filed for record is not notice of the facts constituting fraud.' Recording a deed or entering judgment alone is not enough in some instances to apprise a party of the fraudulent nature of a conveyance.

Since the Dygerts did not have a duty to search the title records,[26] they cannot be charged with constructive notice of a fraud perpetrated by Appellees.

Justifiable Reliance Is Jury Issue

The trial court's conclusion, as a matter of law, that the Dygerts "cannot demonstrate a justifiable reliance" on information provided by Appellees invades the province of the jury.[27] Therefore, this conclusion should be reversed.

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[26] *Christenson v. Commonwealth Land Title Insurance Co.*, 666 P.2d 302, (UT 1983) and *Dugan v. Jones*, 615 P.2d 1239 (UT 1980).

[27] *Robinson v. Tripco Investments*, Inc., 21 P.3d 219, 224 (UT App. 2000)("[T]he question of whether a plaintiff was reasonable in his or her reliance is 'usually a matter within the province of the jury.'").

CONCLUSION

This is a "garden variety" fraud case.[28] Appellees should not be given safe harbor under their LLC from the consequences of their wrongful conduct. Neither the legislature nor the common law has intended to countenance such protections.

Accordingly, the Dygerts respectfully request that this Honorable Court reverse the trial court's order granting summary judgment and remand this case to the trial court with directions to set a jury trial on all counts alleged against Appellees in the Dygerts' *Amended Complaint.*

DATED this 3rd day of June, 2003.

BEARNSON & PECK, LC

Marty E. Moore
Attorneys for Daniel K. and Stephanie C. Dygert

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[28] *Von Hake v. Thomas*, 705 P.2d 766, 770 (UT 1985)("[T]hese facts present something of a 'garden variety' fraud case, in which one part intentionally or recklessly misrepresents a presently existing material fact, thereby inducing another to reasonably rely and act upon that falsehood to the other's detriment.").

Case No. 20020878

IN THE

UTAH COURT OF APPEALS

DANIEL K. DYGERT and **STEPHANIE C. DYGERT,**

Plaintiffs and Appellants

v.

ALAN M. COLLIER and **MIKE YOUNGBERG,**

Defendants and Appellees

BRIEF OF APPELLANTS

ADDENDUM

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ADDENDUM TABLE OF CONTENTS

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IN THE SECOND JUDICIAL DISTRICT COURT IN AND FOR THE

COUNTY OF DAVIS, STATE OF UTAH

DANIEL K. DYGERT and STEPHANIE C. DYGERT, Plaintiffs, vs. CHICAGO TITLE INSURANCE COMPANY; BONNEVILLE TITLE COMPANY, INC.; CLEARWATER OAKS, L.C.; ALAN M. COLLIER; and MIKE YOUNGBERG, Defendants.	**ORDER** Civil No. 010800994 Judge Glen R. Dawson

Defendants, Alan M. Collier and Mike Youngberg's, Motion for Summary Judgment came before this Court for oral argument n August 20, 2002. The Court, having taken the matter under advisement, rendered its decision on September 17, 2002 via telephone conference. Plaintiffs were represented by their attorney, Marty Moore, and Defendants Collier and Youngberg were represented by their attorney, Robert W. Hughes. The Court having reviewed Defendants Collier and Youngberg's Motion and supplemental Memoranda and Plaintiffs' Memorandum, the other pleadings and papers on file herein, the Court having made and entered its Findings of Fact and Conclusions of Law, and good cause appearing therefor,

IT IS HEREBY ORDERED:

1. Defendants Collier and Youngberg's Motion for Summary Judgment is granted.

2. Plaintiffs' Complaint against Defendants Collier and Youngberg is dismissed.

DATED this 9th day of Oct., 2002

BY THE COURT:

HONORABLE GLEN R. DAWSON
District Court Judge

STATE OF UTAH
SECOND DISTRICT COURT
BOUNTIFUL

APPROVED AS TO FORM:

MARTY E. MOORE
Attorney for Plaintiffs

CERTIFICATE OF MAILING

I hereby certify that I mailed a copy of the foregoing Order to Brad N. Bearnson and Marty E. Moore, BEARNSON & PECK, L.C., 74 West 100 North, Logan, Utah 84321, and Stephen F. Noel, SMITH, KNOWLES & HAMILTON, 4723 Harrison Blvd. #200, Ogden, Utah 84403, postage prepaid, this 20 day of September, 2002.

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IN THE SECOND JUDICIAL DISTRICT COURT IN AND FOR THE

COUNTY OF DAVIS, STATE OF UTAH

DANIEL K. DYGERT and STEPHANIE C. DYGERT, Plaintiffs, vs. CHICAGO TITLE INSURANCE COMPANY; BONNEVILLE TITLE COMPANY, INC.; CLEARWATER OAKS, L.C.; ALAN M. COLLIER; and MIKE YOUNGBERG, Defendants.	**FINDINGS OF FACT AND CONCLUSIONS OF LAW** Civil No. 010800994 Judge Glen R. Dawson

Defendants, Alan M. Collier and Mike Youngberg's, Motion for Summary Judgment came before the Court for oral argument on August 20, 2002. The Court, having taken the matter under advisement, rendered its decision on September 17, 2002 via telephone conference. Plaintiffs were represented by their attorney, Marty Moore, and Defendants Collier and Youngberg were represented by their attorney, Robert W. Hughes. The Court having reviewed Defendants Collier and Youngberg's Motion and supplemental Memoranda and Plaintiffs' Memorandum, the other pleadings and papers on file herein, now makes the following:

FINDINGS OF FACT

1. Defendant Clearwater Oaks, L.C. was organized and its Articles of Organization were filed with the Utah State Department of Commerce on November 28, 1997, and was, at all times relevant hereto, a valid existing limited liability company in good standing with the State of Utah.

2. Defendants Alan Collier and Mike Youngberg were, at all times relevant hereto, the members of Clearwater Oaks, L.C.

3. Defendant Clearwater Oaks, L.C. was the owner of a subdivision located in Davis County, State of Utah known as the "Clearwater Oaks Subdivision" (the "Subdivision").

4. At no time did either Defendant Collier or Defendant Youngberg personally own the Subdivision.

5. Plaintiffs purchased a certain lot in the Subdivision from Defendant Clearwater Oaks, L.C. described as Lot 2, Clearwater Oaks Subdivision (the "Property").

6. The purchase of the Property by Plaintiffs from Defendant Clearwater Oaks, L.C. was an arm's length transaction.

7. The individual Defendants did not sign personally any documents related to the sale of the Property to Plaintiffs.

8. At the time the Plaintiffs purchased the Property from Defendant Clearwater Oaks, L.C., there was a lease affecting the Property in favor of Reagan Sign Company (the "Lease") which was recorded as Entry No. 1127166, Book 1773, Page 460 in the office of the Davis County Recorder on the 17th day of May 1994.

9. Neither Defendant Collier nor Defendant Youngberg individually had a legal duty to Plaintiffs in the sale of the Property from Defendant Clearwater Oaks, L.C. to Plaintiffs.

10. Utah Code Ann. §Ann. §48-2c-104 [The Utah Revised Limited Liability Company Act] provides:

> A company formed under this chapter is a legal entity distinct from its members.

11. Utah Code Ann. §48-2c-116 provides:

> A member or manager of a company is not a proper party to proceedings by or against a company, except when the object is to enforce a member's or manager's right against, or liability to, the company.

12. Utah Code Ann. §48-2c-601 provides:

> Except as provided in Section 48-2c-602, no organizer, member, manager, or employee of a company is personally liable under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of the company or for the acts or omissions of the company or of any other organizer, member, manager, or employee of the company.

13. Utah Code Ann. §57-3-102(1) provides in relevant part:

> Each document executed, acknowledged, and certified, in the manner prescribed by this title.,... shall from the time of recording with the appropriate county recorder, impart notice to all persons of their contents.

The Court having made and entered its Findings of Fact, now make and enter the following:

CONCLUSIONS OF LAW

1. Defendants Collier and Youngberg as member of Clearwater Oaks, L.L.C. cannot be held personally liable for the acts of Defendant Clearwater Oaks.

2. Defendants Collier and Youngberg individually did not have a legal duty to the Plaintiffs in the sale of the Property by Defendant Clearwater Oaks, L.C. to Plaintiffs.

3. Plaintiffs had legal notice of the Lease at the time they purchased the Property.

4. Because the Lease the Plaintiffs claim encumbered the Property was a public record, the Plaintiffs cannot demonstrate a justifiable reliance and therefore the causes of action against Defendants Collier and Youngberg must be dismissed.

5. Defendants Collier and Youngberg are not proper parties to the litigation and the causes of action against them personally should be dismissed.

DATED this 9th day of ~~September~~ October, 2002

BY THE COURT:

HONORABLE GLEN R. DAVSON
District Court Judge

STATE OF UTAH SECOND DISTRICT COURT BOUNTIFUL

APPROVED AS TO FORM:

MARTY E. MOORE
Attorney for Plaintiffs

CERTIFICATE OF MAILING

I hereby certify that I mailed a copy of the foregoing Findings of Fact and Conclusions of Law to Brad N. Bearnson and Marty E. Moore, BEARNSON & PECK, L.C., 74 West 100 North, Logan, Utah 84321 and Stephen F. Noel, SMITH, KNOWLES & HAMILTON, 4723 Harrison Blvd. #200, Ogden, Utah 84403, postage prepaid, this 20th day of September, 2002.

AND MERIDIAN. — WEST BOUNTIFUL CITY, UTAH

Lot — Dan Daggett — 84025
676 So. 100 E. Farmington

FOUND MONUMENT AT SOUTHEAST COR
SEC 13, T2N, R1W SLB&M
N 123945.47
E 113068.47

LINE 1394.79' S 0°20'53" E 2653.00' BASIS OF BEARING

1077.99'

Meet Monday 5:30
W/Builder — Mar. 22nd

Plans Creations West
3075 N. Fairfield - Layton
M-F 12-5

N123833.14
E112909.90

N123585.26
E112910.21

N123403.79
E112907.14

N123368.32
E112905.95

N123310.03
E112901.57

10' FRONT & REAR P.U.E. (TYPICAL)
7' SIDE YARD P.U.E. (TYPICAL)

S 00°04'16" E 247.88'

S 00°57'58" W 181.50'

S 01°56'02" E 35.48'

S 04°17'09" W 58.45'

S 01°49'03" W 122.79'

WEST 422.02'

10' FRONT & REAR P.U.E. (TYPICAL)

P.U.E., SIGN & FENCE LINE EASEMENT

S 00°17'20" W 88.00'

28' POWER LINE EASEMENT

10' P.U.E.

Horse Property

Lot	Area	Address
8	20,132 SF 0.462 AC	1500 N
7	20,180 SF 0.463 AC	1480 N
6	20,225 SF 0.464 AC	1460 N
5	20,258 SF 0.465 AC	1440 N
4	20,313 0.466 AC	1420 N
3	20,603 SF 0.473 AC	1400 N
2	20,932 SF 0.481 AC	1380 N
1	23,163 SF 0.532 AC	1360 N

N 86°22'19" W 252.92'

550 WEST STREET

C1 C2 C3 C4 C5 C6

10' FRONT & REAR P.U.E. (TYPICAL)
7' SIDE YARD P.U.E. (TYPICAL)

25581.14
12671.71

25581.29
12646.70

Set-back from Street 30'

2 acres.

Horse 40 ac.

- from any ducks residence

American Jurisprudence, Second Edition
Current through the May 2001 Cumulative Supplement

Corporations
Anne Christine Haberle, J.D.; James L. Jones, J.D.; Jack K. Levin, J.D.; Eric Mayer, J.D.; Jody L. Mikasen, J.D.; Leonard I. Reiser, J.D.; Ferdinand S. Tinio, LL.B., LL.M.

XVI. Rights, Duties, and Liabilities of Directors, Officers, and Employees [§§1684-1989]
P. Liability to Third Persons for Torts of Corporation [§§1877-1891]
1. In General [§§1877, 1878]

Topic Summary; Topic Contents; Parallel References; List of Topics;

§ 1877. GENERALLY

A director or officer of a corporation does not incur personal liability for its torts merely by reason of his official character; he is not liable for torts committed by or for the corporation unless he has participated in the wrong. [FN79] Accordingly, directors not parties to a wrongful act on the part of other directors are not liable therefor. [FN80] If, however, a director or officer commits or participates in the commission of a tort, whether or not it is also by or for the corporation, he is liable to third persons injured thereby, and it does not matter what liability attaches to the corporation for the tort. A contrary rule would enable a director or officer of a corporation to perpetrate flagrant injuries and escape liability behind the shield of his representative character, even though the corporation might be insolvent or irresponsible. [FN81] Liability under those conditions may be recognized by statute. [FN82] Participation may be found not solely on the basis of direct action but may also consist of knowing approval or ratification of unlawful acts. [FN83]

Caution: That a corporate officer is acting for the corporation or within the scope of his employment when he participated in the company's commission of a tort does not affect his liability for the tort. [FN84]

Observation: The liability of a director or corporate officer as a participant in a tort is distinct from the liability resulting from the "piercing of the corporate veil." The effect of piercing a corporate veil is to hold the owner liable, the rationale for doing so being that the corporation is something less than a bona fide independent entity. [FN85] On the other hand, a director or officer who is liable as a participant in a tort is liable as an actor rather than as an owner. His liability is in no way dependent on a finding that the corporation is inadequately capitalized, that the corporation is a mere alter ego of himself, that the corporate form is being used to perpetrate a fraud, or that corporate formalities have not been properly complied with--the absence of such findings does not affect the director's or officer's liability. [FN86]

If, because of the tort committed by an officer or agent of a corporation, the corporation becomes liable also, such individual and the corporation are jointly liable and may be joined as defendants. [FN87]

Practice guide: If a director or officer is sought to be held individually liable for a tort committed by the corporation, he must be made a party in the action against the company. Otherwise, the director or officer cannot be held personally liable without an opportunity to relitigate the issue of the amount of damages. [FN88]

Certain aspects of the liability of corporate officers or agents with respect to particular torts are discussed in the following sections. [FN89] Treated elsewhere is their liability for assault and battery, [FN90] conversion, [FN91] trespass, [FN92] libel, [FN93] maintaining a nuisance, [FN94] and the infringement of copyrights or patents. [FN95]

Practice guide: In a suit against a corporation for tort, a corporate officer who is not a resident of the state

where the corporation is alleged to have committed the tort (and which is thus the proper forum) may be brought within the court's long-arm jurisdiction on the theory that he is personally liable for the tort. [FN96]

CUMULATIVE SUPPLEMENT by the editorial staff of the Publishers.

Research References:

Validity, construction, and application of "fiduciary shield" doctrine-- modern cases, 79 A.L.R. 5th 587.

Supreme Court's views as to validity, construction, and application of Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (42 U.S.C.A. §§9601 et seq.), 157 A.L.R. Fed. 291.

Liability of dissolved corporation or corporation that forfeited charter in action pursuant to Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (42 U.S.C.A §§9601-9675), 123 A.L.R. Fed. 461.

Liability of individual shareholder, or director of corporation that owned contaminating facility in action pursuant to Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) (42 U.S.C.A. §§9601- 9675), 122 A.L.R. Fed. 321.

"Can they take my house?": Defending directors and officers, 81 Ill BJ May:244 (1993).

Coolley, Personal Liability of Corporate Officers and Directors In Intellectual Property Actions? 33 Prac Law 79, June, 1987.

Corporate officer liability as an operator under CERCLA, 9 J Nat Resour and Environ L 2:553 (1994).

Defamation, freedom of speech and corporations, 1993 Juridicial Rev 294 (1993).

Environmental crime and punishment; New proposed guidelines for evaluating corporate culpability, 17 Los Angeles Law 7:20 (1994).

Note, The Fiduciary Shield Doctrine: Minimum Contacts in a Special Context. 65 Bos U LR 967, November, 1985.

Unpacking limited liability: Direct and vicarious liability of corporate participants for torts of the enterprise, 47 Vand LR 1 (1994).

Cases:

Where a third party who entered into a contract with a corporation brought suit against the president-director of the corporation alleging tortious interference with contract, the president-director was not shielded from liability for tortious interference because the president-director only owned 40 percent of the corporation and lacked the unity of financial interest that would warrant considering him the same entity as the corporation. Holloway v Skinner (1993, Tex App Austin) 860 SW2d 217, writ of error filed (Oct 26, 1993).

[FN79]. Numerous decisions from many jurisdictions support this rule, including the following representative cases: Washington Gas Light Co. v Lansden, 172 US 534, 43 L Ed 543, 19 S Ct 296; Shingleton v Armor Velvet Corp. (CA5 Ga) 621 F2d 180, 6 Fed Rules Evid Serv 685; Escude Cruz v Ortho Pharmaceutical Corp. (CA1 Puerto Rico) 619 F2d 902; Martin v Wood (CA3 Pa) 400 F2d 310; Zubik v Zubik (CA3 Pa) 384 F2d 267, cert den 390 US 988, 19 L Ed 2d 1291, 88 S Ct 1183; Polo Fashions, Inc. v Branded Apparel Merchandising, Inc. (DC Mass) 592 F Supp 648, 225 USPQ 480; United States v ACB Sales & Service, Inc. (DC Ariz) 590 F Supp 561; Candy H. v Redemption Ranch, Inc. (MD Ala) 563 F Supp 505; Hamilton Bank & Trust Co. v Holliday

(ND Ga) 469 F Supp 1229, CCH Fed Secur L Rep ¶96953; Murphy Tugboat Co. v Shipowners & Merchants Towboat Co. (ND Cal) 467 F Supp 841, 1979-1 CCH Trade Cases ¶62527, affd (CA9 Cal) 658 F2d 1256, 1981-1 CCH Trade Cases ¶64000, cert den 455 US 1018, 72 L Ed 2d 135, 102 S Ct 1713; Smith v Fidelity Mut. Life Ins. Co. (SD NY) 444 F Supp 594; Independence Tube Corp. v Copperweld Corp. (ND Ill) 74 FRD 462, 1977-1 CCH Trade Cases ¶61416, 23 FR Serv 2d 736; Re Wade (F BC ND Ill) 26 BR 477; Crigler v Salac (Ala) 438 So 2d 1375; United States Liability Ins. Co. v Haidinger-Hayes, Inc., 1 Cal 3d 586, 83 Cal Rptr 418, 463 P2d 770; Middlesex Ins. Co. v Mann (4th Dist) 124 Cal App 3d 558, 177 Cal Rptr 495; Dunbar v Finegold (Colo App) 501 P2d 144; Scribner v O'Brien, Inc., 169 Conn 389, 363 A2d 160; Gordon Finance, Inc. v Belzaguy (Fla App D3) 216 So 2d 240; McLanahan v Keith, 135 Ga App 117, 217 SE2d 420; Rodriguez v Nishiki, 65 Hawaii 430, 653 P2d 1145, 9 Media L R 1349; Cahill v Hawaiian Paradise Park Corp., 56 Hawaii 522, 543 P2d 1356; Fure v Sherman Hospital, 55 Ill App 3d 572, 13 Ill Dec 448, 371 NE2d 143; American Independent Management Systems, Inc. v McDaniel (Ind App) 443 NE2d 98; Bowling v Holdeman (Ind App) 413 NE2d 1010; Kansas Com. on Civil Rights v Service Envelope Co., 233 Kan 20, 660 P2d 549, 32 CCH EPI ' 33632; Galvan v McCollister, 224 Kan 415, 580 P2d 1324; Moak v Link-Belt Co. (La App 4th Cir) 229 So 2d 395, revd on other grounds 257 La 281, 242 So 2d 515; Baranowski v Strating, 72 Mich App 548, 250 NW2d 744; Patzman v Howey, 340 Mo 11, 100 SW2d 851; Boyd v Wimes (Mo App) 664 SW2d 596; Robbins v Panitz, 61 NY2d 967, 475 NYS2d 274, 463 NE2d 615; Connell v Hayden (2d Dept) 83 App Div 2d 30, 443 NYS2d 383; Air Traffic Conference, Div. of Air Transport Asso. v Marina Travel, Inc., 69 NC App 179, 316 SE2d 642; Schollmeyer v Saxowsky (ND) 211 NW2d 377; Schaefer v D & J Produce, Inc., 62 Ohio App 2d 53, 16 Ohio Ops 3d 108, 403 NE2d 1015, motion overr; Wicks v Milzoco Builders, Inc., 503 Pa 614, 470 A2d 86; Hunt v Rabon, 275 SC 475, 272 SE2d 643; Zang v Leonard (Tenn App) 643 SW2d 657; Cooper v Cordova Sand & Gravel Co. (Tenn App) 485 SW2d 261; Houston Chronicle Pub. Co. v Stewart (Tex App Houston (1st Dist)) 668 SW2d 727, writ dism w o j; Grayson v Nordic Constr. Co., 92 Wash 2d 548, 599 P2d 1271; Cato v Silling, 137 W Va 694, 73 SE2d 731, cert den 348 US 981, 99 L Ed 764, 75 S Ct 572, reh den 349 US 924, 99 L Ed 1256, 75 S Ct 659; Kiel v Frank Shoe Mfg. Co., 245 Wis 292, 14 NW2d 164, 152 ALR 691.

Specific direction or sanction of, or active participation or co-operation in, a positively wrongful act of commission or omission which operates to the injury or prejudice of the complaining party, is necessary to generate individual liability in damages of an officer or agent of a corporation for the tort of the corporation. Lobato v Pay Less Drug Stores, Inc. (CA10 NM) 261 F2d 406.

The mere fact that a corporation, through its board of directors, approves a transaction which it should have reason to believe is illegal, does not of itself bring personal liability on the president of the corporation. Alliegro v Pan American Bank (Fla App D3) 136 So 2d 656, cert den (Fla) 149 So 2d 45.

As to liability of officers or directors for participation in issuance of securities in violation of state securities laws, see § 516.

[FN80]. Smith v Cornelius, 41 W Va 59, 23 SE 599.

[FN81]. Representative of the numerous cases in support of this principle are the following: Escude Cruz v Ortho Pharmaceutical Corp. (CA1 Puerto Rico) 619 F2d 902; L. C. L. Theatres, Inc. v Columbia Pictures Industries, Inc. (CA5 Tex) 619 F2d 455; Zubik v Zubik (CA3 Pa) 384 F 2d 267, cert den 390 US 988, 19 L Ed 2d 1291, 88 S Ct 1183; Polo Fashions, Inc. v Branded Apparel Merchandising, Inc. (DC Mass) 592 F Supp 648, 225 USPQ 480; United States v Wade (ED Pa) 577 F Supp 1326; Pocahontas First Corp. v Venture Planning Group, Inc. (DC Nev) 572 F Supp 503; All American Car Wash, Inc. v National Pride Equipment, Inc. (WD Okla) 550 F Supp 166; Polyglycoat Corp. v C. P. C. Distributors, Inc. (SD NY) 534 F Supp 200; Citronelle-Mobile Gathering, Inc. v O'Leary (SD Ala) 499 F Supp 871; MacMillan Co. v I.V.O.W. Corp. (DC Vt) 495 F Supp 1134, 209 USPQ 739; Grove Press, Inc. v Central Intelligence Agency (SD NY) 483 F Supp 132; Re Firestone (F BC SD Fla) 26 BR 706; Re Inforex, Inc. (F BC DC Mass) 26 BR 515, 9 BCD 1373; Alabama Music Co. v Nelson, 282 Ala 517, 213 So 2d 250; Chandler v Hunter (Ala App) 340 So 2d 818, 21 UCCRS 484; Rhoads v Harvey Publications, Inc. (App) 124 Ariz 406, 604 P2d 670, later app (App) 131 Ariz 267, 640 P2d 198; Jabczenski v Southern Pacific Memorial Hospital, Inc. (App) 119 Ariz 15, 579 P2d 53; Wyatt v Union Mortg. Co., 24 Cal 3d 773, 157 Cal Rptr 392, 598 P2d 45; Middlesex Ins. Co. v Mann (4th Dist) 124 Cal App 3d 558, 177 Cal Rptr 495; Mayes v Sturdy Northern Sales, Inc. (1st Dist) 91 Cal App 3d 69, 154 Cal Rptr 43; Dunbar v Finegold (Colo App) 501 P2d 144; Scribner v O'Brien, Inc., 169 Conn 389, 363 A2d 160; Naranja Lakes

Condominium No. One, Inc. v Rizzo (Fla App D3) 422 So 2d 1080, later app (Fla App D3) 463 So 2d 378, 10 FLW 245; Orlovsky v Solid Surf, Inc. (Fla App D4) 405 So 2d 1363; Lincoln Land Co. v Palfery, 130 Ga App 407, 203 SE2d 597; National Acceptance Co. v Pintura Corp., 94 Ill App 3d 703, 50 Ill Dec 120, 418 NE2d 1114; Stansell v International Fellowship, Inc., 22 Ill App 3d 959, 318 NE2d 149; Howard Dodge & Sons, Inc. v Finn, 181 Ind App 209, 391 NE2d 638, 26 UCCRS 886; Grefe v Ross (Iowa) 231 NW2d 863; Kansas Com. on Civil Rights v Service Envelope Co., 233 Kan 20, 660 P2d 549, 32 CCH EPI ¶33632; Henkin, Inc. v Berea Bank & Trust Co. (Ky App) 566 SW2d 420, 23 UCCRS 1225; H. B. "Buster" Hughes, Inc. v Bernard (La) 318 So 2d 9, later app (La App 4th Cir) 355 So 2d 1027; Bart Arconti & Sons, Inc. v Ames-Ennis, Inc., 275 Md 295, 340 A2d 225; Levi v Schwartz, 201 Md 575, 95 A2d 322, 36 ALR2d 1241; La Clair v Silverline Mfg. Co., 379 Mass 21, 393 NE2d 867; Trail Clinic, P.C. v Bloch, 114 Mich App 700, 319 NW2d 638; Morgan v Eaton's Dude Ranch, 307 Minn 280, 239 NW2d 761, 90 ALR3d 912; Little v Grizzly Mfg., 195 Mont 419, 636 P2d 839, 32 UCCRS 1087; Bernier Bros., Inc. v Biron, 109 NH 555, 258 A2d 339; Pacific & Atlantic Shippers, Inc. v Schier, 109 NH 551, 258 A2d 351; Trustees of Structural Steel & Ornamental Iron Workers Fund v Huber, 136 NJ Super 501, 347 A2d 10, certif den 70 NJ 143, 358 A2d 190; Robbins v Panitz, 61 NY2d 967, 475 NYS2d 274, 463 NE2d 615; Connell v Hayden (2d Dept) 83 App Div 2d 30, 443 NYS2d 383; Bernstein v Polo Fashions, Inc. (1st Dept) 55 App Div 2d 530, 389 NYS2d 368; United Artists Records, Inc. v Eastern Tape Corp., 19 NC App 207, 198 SE2d 452, 179 USPQ 824, 1973-2 CCH Trade Case ¶74738; Stuart v National Indem. Co., 7 Ohio App 3d 63, 7 Ohio BR 76, 454 NE2d 158; Stony Ridge Hill Condominium Owners Assn. v Auerbach, 64 Ohio App 2d 40, 18 Ohio Ops 3d 26, 410 NE2d 782, motion overr; Beri, Inc. v Salishan Properties, Inc., 282 Or 569, 580 P2d 173; Wicks v Milzoco Builders, Inc., 503 Pa 614, 470 A2d 86; Amabile v Auto Kleen Car Wash, 249 Pa Super 240, 376 A2d 247; Hunt v Rabon, 275 SC 475, 272 SE2d 643; Brungard v Caprice Records, Inc. (Tenn App) 608 SW2d 585; Gardner Machinery Corp. v U. C. Leasing, Inc. (Tex Civ App Beaumont) 561 SW2d 897, writ granted; Wichita Falls Grain Co. v Taylor Foundry Co. (Tex App Fort Worth) 649 SW2d 7

While a director or officer of a corporation does not incur personal liability for its torts merely by reason of his official character, yet a director or officer who commits the tort or who directs the tortious act done, or participates or operates therein, is liable to third persons injured thereby, even though liability may also attach to the corporation for the tort. Evans v Rohrbach, 35 NJ Super 260, 113 A2d 838.

[FN82]. Admiral Corp. v Cohen, 68 Misc 2d 687, 327 NYS2d 422.

[FN83]. Murphy Tugboat Co. v Shipowners & Merchants Towboat Co. (ND Cal) 467 F Supp 841, 1979-1 CCH Trade Cases ¶62527, affd (CA9 Cal) 658 F2d 1256, 1981-1 CCH Trade Case ¶64000, cert den 455 US 1018, 72 L Ed 2d 135, 102 S Ct 1713.

[FN84]. Crigler v Salac (Ala) 438 So 2d 1375; Littman v Commercial Bank & Trust Co. (Fla App D3) 425 So 2d 636, 35 UCCRS 678; Orlovsky v Solid Surf, Inc. (Fla App D4) 405 So 2d 1363; Adams v Brickell Townhouse, Inc. (Fla App D3) 388 So 2d 1279; Bush v Belenke (Fla App D3) 381 So 2d 315; Dade Roofing & Insulation Corp. v Torres (Fla App D3) 369 So 2d 98; Cic Leasing Corp. v Dade Linen & Furniture Co. (Fla App D3) 279 So 2d 73; Warren Tool Co. v Stephenson, 11 Mich App 274, 161 NW2d 133, 5 UCCRS 1017.

[FN85]. Generally, as to disregard of the corporate entity, see §§ 43 et seq.

[FN86]. Donsco, Inc. v Casper Corp. (CA3 Pa) 587 F2d 602, 199 USPQ 705; Wicks v Milzoco Builders, Inc., 503 Pa 614, 470 A2d 86.

The rule under which a director or officer may be held liable as a participant in a tort does not depend on the same grounds as "piercing the corporate veil," that is, inadequate capitalization, use of the corporate form for fraudulent purposes, or failure to comply with the formalities of corporate organization. Crigler v Salac (Ala) 438 So 2d 1375.

[FN87]. § 2124.

[FN88]. Dunbar v Finegold (Colo App) 501 P2d 144.

[FN89]. As to fraud, see §§ 1882 et seq.
As to negligence, see §§ 1889 et seq.

[FN90]. 6 Am. Jur. 2d, Assault and Battery § 126.

[FN91]. 18 Am. Jur. 2d, Conversion § 73.

[FN92]. 75 Am. Jur. 2d, Trespass § 75.

[FN93]. 50 Am. Jur. 2d, Libel and Slander § 329.

[FN94]. 58 Am. Jur. 2d, Nuisances § 58.

[FN95]. 18 Am. Jur. 2d, Copyright and Literary Property §§198, 199; 60 Am. Jur. 2d, Patent § 410.

[FN96]. Lee B. Stern & Co. v Green (Fla App D3) 398 So 2d 918.

AMJUR CORPORATNS § 1877
END OF DOCUMENT

Facing the Consequences

Personal Liability of Corporate Officers

by C. Erik Gustafson

Among many other purposes, businesses elect to form as a corporation to shield individuals from personal liability. That continues to be the fundamental lesson in law school Corporations classes, and that appears to be the publicly accepted wisdom. Indeed, from the clamor in the popular press to "change" the law to allow individuals to be held personally liable for such business failures as Enron, one would think that an individual, such as an officer of the corporation, may not be found personally liable when his or her actions are cloaked in the name of the corporation. Of course, nothing could be further from the truth—business people cannot always escape the consequences of their actions, even when done in the name of the corporation.

A typical factual scenario in which the issue of officer liability arises in the travel industry (a field in which the author frequently litigates) is as follows. An airline or ticket seller has entered into a contract with a travel agency. As part of the arrangement, the agency will sell goods and services that are provided and facilitated by the airline. To maintain the relationship and pursuant to the contract, the agency must file financial reports on a weekly basis, and must pay the airline based upon the content of the financial reports, including sales data. The contract provides that the goods held by the travel agency will remain in trust until sold. Eventually, the relationship sours when it is discovered that the agency has been underreporting its sales.

While a judgment against the agency for breach of contract is an almost certain result, in most cases it has little or no assets with which to satisfy the judgment. Moreover, absent a sense of moral obligation, the individual owners of the business likely believe themselves to be free from legal responsibility for these debts and will not voluntarily repay these "business" losses. Looking to the officer responsible for the misreporting has often proven a fruitful course of recovery, and, in the past few years, courts have generally agreed that personal liability may be found in such cases.

Personal Liability Without Piercing the Corporate Veil

Although an individual may become liable in instances in which the corporate veil is pierced, one need not pursue that often-difficult path to hold an officer of a corporation personally liable. A corporation can only act through its directors and officers. Generally, an officer director is not liable for his or her conduct relation to the acts of the corporation. Howev an officer of a corporation is personally liat for intentional torts, such as breach of fiducia duty, conversion, or breach of trust, that he she commits on behalf of the corporatio *PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368, Cal.Rptr.2d 663 (2000) (officer may be liable competitor of corporation for misappropri tion of trade secrets where officer invested i was in control of, and directed or authoriz general corporate operations directed towa unlawful conduct); *Kilduff v. Adams, Inc.*, 2 Conn. 314, 593 A.2d 478 (1991) (an offic who commits a tort is personally liable to t victim regardless of whether the corporatic is liable); *First Financial USA, Inc. v. Steinge* 760 So.2d 996 (Fla.App. 2000) (officer may b personally liable for fraud in the inducemen although actions were committed when ac ing on behalf of corporation); *L. B. Industrie Inc. v. Smith*, 631 F.Supp. 922 (D.Idaho 198 (officer may be liable for corporation's wron ful acts that he directs or sanctions); *Ande son v. Heartland Oil & Gas, Inc.*, 249 Kan. 45 819 P.2d 1192 (1991) (officer and corporatio may be jointly liable for officer's fraudule promise of future events involving investmer scheme); *Turner v. Wilson*, 620 So.2d 545 (Mis 1993) (officer may be liable to corporation creditors when he has participated in the tor tuous act, or has authorized or directed it, o has acted in his own behalf, or has had an knowledge of, or given any consent to, the ac or transaction, or has acquiesced in it whe he either knew or by the exercise of reason able care should have known of it and shoul have objected and taken steps to prevent it) *Lopresti v. Terwilliger*, 126 F.3d 34 (2d Cir. 1997 (officer may be personally liable to corpora tion's employees for conversion where funds were used for other business purposes anc not deposited into ERISA accounts); *Texas v Mink*, 990 S.W.2d 897 (Tex.App. 1999) (of ficer personally liable where actions caused corporation to breach its fiduciary duty to creditor); *Cook v. The 1031 Exchange Corp.*, 29 Va.Cir. 302, 1992 Va.Cir.LEXIS 31; *Amer ican Honda Finance Corp. v. Francis*, Civ.A. 92 0085-B, 1993 U.S.Dist.LEXIS 442 (W.D.Va. 1993) (finding corporate officer had fiduciary duty to company's creditors and remanding case to bankruptcy court on question of "whether a 'defalcation' occurred"); *Transgo, Inc. v. Ajac Transmission Parts Corp.*, 768 F.2d 1001, 1021

C. Erik Gustafson is a shareholder in the Alexandria, Virginia office of LeClair Ryan, a professional corporation. Mr. Gustafson routinely represents clients in commercial disputes, in the defense of insurance and surety claims, and in prosecuting claims in bankruptcy matters.

9th Cir. 1985); *DER Travel Services, Inc. v. Dream Tours & Adventures, Inc.*, 2001 U.S. Dist.LEXIS 15581 (S.D.N.Y. 2001) (corporate octrine does not provide any protection to orporate agents or owners with respect to eir own liabilities and obligations, incurred s a result of their own acts).

"[O]ne whose actions taken in bad faith ause tortious injury to another is not insuted from personal liability merely because the alefactor was a corporate officer, director, or nployee acting within the scope of employent at the time of the commission of the fraud." *re Pontier*, 165 B.R. 797, 799 (Bankr.D.Md. 94). In *Transgo v. Ajac Transmission Parts, pra*, the Ninth Circuit held the president of corporation personally liable for the corpor- ion's "acts of unfair competition." 768 F.2d at 21. The president conspired with another cor- ration to imitate the mechanical part manu- tured by another company and try to pass it as its product. Due to the "instrumental role" at the president played in the conspiracy, the urt concluded that the evidence supported finding of personal liability. *Id.* Thus, even hout piercing the corporate veil, an officer director can be found personally liable. See *re Ketaner*, 154 B.R. 459, 464 (Bankr.E.D.Va. 92) (finding it unnecessary to discuss pierc- the corporate veil because the debtor, as an cer, could be held personally liable for the dulent conduct of the corporation in which participated).

While it may seem obvious that intentional s may result in personal liability, omissions y also lead to liability. Corporate officers equally liable for the torts they cause by r omissions as well as acts of commission: pecific direction or sanction of, or active articipation or cooperation in, a positively rongful act of commission or *omission* hich operates to the injury or prejudice of e complaining party [generates] individ- al liability in damages of an officer or a orporation for the tort of the corporation. *nan v. Wheaton-Haven Recreation Asso- n, Inc.*, 517 F.2d 1141, 1145 (4th Cir. 1975) phasis added). See also, *In re Pontier, su-* 165 B.R. at 801, citing *Cruz v. Ortho Phar- utical Corp.*, 619 F.2d 902, 907 (1st Cir.); *Camacho v. 1440 Rhode Island Ave. Corp.*, A.2d 242, 246-47 (D.C.App. 1993).

cently, a federal court in Virginia elabo- on this standard of potential omission, ng that an officer of a travel agency may ld liable for breach of the agency's fiduciary duty if "he participates in, ratifies, or otherwise authorizes the corporation's breach of its fiduciary duty... [and] may be held liable if he fails to exercise the same degree of discretion in the management of trust that a prudent man would exercise in his own affairs." *Airlines Reporting Corp. v. Pishvaian*, 155 F.Supp.2d 659, 667 (E.D.Va. 2001). Thus, an officer may become personally liable not only by acting inappropriately, but also by failing to act appropriately. The California courts have stated this principle more broadly:

> A corporate officer or director, like any other person, owes a duty to refrain from injuring others. In the context of a negligence claim, the Supreme Court has held that, like any other person, "directors individually owe a duty of care, independent of the corporate entity's own duty, to refrain from acting in a manner that creates an unreasonable risk of injury to third parties...." Stated differently, the Supreme Court held: "Like any other citizen, corporate officers have a societal duty to refrain from acts that are reasonably risky to third persons even when their shareholders or creditors would agree that such conduct serves the institution's best interests."

PMC, Inc. v. Kadisha, supra, 78 Cal.App.4th at 1381, citing *Frances T. v. Village Green Owners Association*, 42 Cal.3d 490, 229 Cal.Rptr. 456 (1986).

Business people cannot always escape the consequences of their actions, even when done in the name of the corporation.

Personal Liability of Officers and Directors

Consistent with the general principles discussed above, several courts around the country have specifically addressed the issue of the individual liability of officers and directors of corporate travel agencies that have defaulted in their obligations.

The Maryland federal district court has found that a vice president and shareholder of a travel agency who personally participated in the agency's defalcation of funds belonging to the airlines could be held personally liable for that defalcation. In *In re Folliard*, 10 B.R. 875 (D.Md. 1981), Pan American World Airways filed a non-dischargeability complaint against Robert Folliard, Jr., the vice president and a shareholder of Welcome Aboard Vacation Center of Washington, D.C., Inc., a travel agency. That agency was accredited by the Air Traffic Conference of America, but was terminated by ATC when it issued drafts for its weekly sales that were subsequently returned for insufficient funds. Following the agency's termination, Folliard filed for personal bankruptcy. Pan Am eventually filed a complaint to determine the dischargeability of its debt, alleging that its claim arose out of Folliard's conversion and defalcation of Pan Am's funds while acting in a fiduciary capacity.

Following a trial on the Pan Am complaint, the bankruptcy court concluded that while Folliard could be held liable for the debt, the debt could be discharged unless he personally profited from the activity. On appeal, the district court overturned the bankruptcy court's ruling, holding that Folliard's participation in the tortious activity alone was sufficient to find the debt to be non-dischargeable, regardless of whether Folliard as an officer actually benefited from the activity. 10 B.R. at 877-78.

In *Forastieri v. Eastern Air Lines, Inc.*, No. 79-2544, 1983 U.S.Dist.LEXIS 15698 (D.P.R. 1983), under similar circumstances, the United States District Court in Puerto Rico held two directors and officers of a travel agency personally responsible for the acts of the agency. The court found that the acts of the two directors were such that to allow them to escape personal liability "would be to sanction fraud, illegality and injustice." *Forastieri*, 1983 U.S.Dist.LEXIS 15698, at *10.

In granting summary judgment for the plaintiff, the *Forastieri* court found that the individual officers were liable for their participation in the conversion of the traffic documents (*i.e.*, tickets) and sales proceeds required by the underlying corporate contract to be held in trust by the agency. *Id.* at *13-*15. Finding the officer was liable for the conversion, regardless of whether the agency's corporate veil should be pierced, the *Forastieri* court stated (*id.* at *14), citing *Emmert v. Drake*, 224 F.2d 299, 302 (5th Cir. 1955):

> Irrespective of good faith or intent, in an instance wherein the corporation had a duty to pay out funds from designated proceeds

but such proceeds were used for other purposes, the directors were held personally liable because they had a duty to see that the funds were used for the agreed-upon purpose and they could not excuse themselves on the grounds that they did not dissipate or misappropriate the funds nor were in other respects derelict in their duty.

The court continued, "[w]ith respect to the context of the failure of a travel agency to remit funds collected from the sale of tickets, the personal liability of officers participating in the conversion of the funds held in trust has found clear judicial support." *Id.* at *15, citing *ATC v. Worldmark Travel*, 15 Aviation Cases, No. 18,483 (CCH 1980); *Folliard, supra*. The court agreed that "failure to remit funds collected by a corporate agent which belong to its principal airline [gave] rise to personal liability of those corporate employees who participated in the conversion." 1983 U.S.Dist.LEXIS 15698, at *16. Thus, even without piercing the corporate veil, the officers were liable to the extent of their participation in the defalcation.

In *Airlines Reporting Corp. v. Inter Transit Travel, Inc.*, 884 F.Supp. 83 (E.D.N.Y. 1995), the federal court in Brooklyn determined that an individual shareholder of a corporation was liable to the creditor for conversion where he failed to report properly the travel agency's ticket sales and also failed to seek approval for the sale of his shares in the travel agency, which agency subsequently was terminated with a $202,000 loss, caused solely by the new owners. The *Inter Transit* court determined that even though the "former" owner was not directly involved in misappropriating the agency's funds, he was fully liable for the conversion of those funds because his activities in failing to adhere to the terms of the agreement with Airlines Reporting Corp. with respect to changes in agency ownership "set the stage for the misappropriation." *Id.* at 87.

A federal bankruptcy court in Virginia recently held that the abdication of control and responsibility over trust property to another individual who ultimately caused extensive losses constituted a breach of fiduciary duty on the part of the individual officer who established the underlying arrangement with the damaged creditor. *In re Bishop*, No. 7-00-00479 (Bankr.W.D.Va. 2001). Among its rulings, the court concluded that the corporate characteristic of limited liability did not shield the individual officer from personal liability to the corporation's creditor because he was personally involved in and authorized a third-party agreement, the essence of which was a breach of the obligations that the corporation had assumed with the creditor. Because of the officer's personal and controlling involvement in both the creation of the underlying trust and in its breach, the court had no difficulty in finding liability and determining that the liability should be non-dischargeable in the officer's personal bankruptcy case.

Note that in order to be personally liable, the officer need not have actually received personal gain from the loss of the creditor. *Dixon v. Texas*, 808 S.W.2d 721 (Tex.App. 1991) (officer may be liable for any tort committed by the corporation through him, regardless of whether the officer personally benefits from the tort committed); *Lopresti v. Terwilliger, supra; In re Folliard, supra; Forastieri v. Eastern Air Lines, supra; Airlines Reporting Corp. v. Pishvaian, supra.*

Intentional Torts–Is "Intention" Really Required?

Accepting as a legal principle that an officer may be held liable for an intentional tort, how high of a hurdle does this present practically? With respect to the torts of conversion and breach of fiduciary duty, it would appear that the issue of intention is truly just a hurdle, rather than a bar.

"Conversion" seems to be a polite word for theft. Under Virginia law, for example, conversion is the wrongful exercise of ownership over the goods of another, when such exercise excludes the rights of the true owner. *McCormick v. AT&T Technologies, Inc.*, 934 F.2d 531, 535 (4th Cir.1991), citing *Buckeye National Bank v. Huff and Cook*, 114 Va. 1, 75 S.E. 769, 772 (1912). This is virtually the same definition used throughout the country. *FMC Corp. v. Capital Cities/ABC, Inc.*, 915 F.2d 300 (7th Cir. 1990); *Moore v. Regents of University of California*, 215 Cal.App.3d 709, 249 Cal.Rptr. 494, 503 (1988), citing *18 Am.Jur.2d*, "Conversion," at 145-46; *Waisath v. Luck's Stores, Inc.*, 474 S.W.2d 444, 447 (Tex. 1971). Conversion does not require that the accused party benefited from the action:

> Any distinct act of dominion wrongfully exerted over the property of another, and in denial of his rights or inconsistent therewith, may be treated as a conversion and it is not necessary that the wrongdoer apply the property to his own use.

Cook v. 1031 Exchange, supra, 29 Va.Cir. at 304, citing *Universal C.I.T. Credit Corp. v. Kaplan*, 198 Va. 67, 76, 92 S.E.2d 359 (1956). No that intention is not a required element of th tort. Nor is it required that the person cor verting the property do so for his own use.

In the context of travel agency litigatio courts have routinely held that the failure t adhere to the terms of the underlying contra results in the conversion of the traffic docu ments and/or conversion of the proceeds fro their sale. *Airlines Reporting Corp. v. Inter Tran sit Travel, Inc.*, 884 F.Supp. 83 (E.D.N.Y. 1995 (holding a 50 percent shareholder personall liable when he "set the stage" for conversio although he was not personally involved); *Foras tieri v. Eastern Air Lines, supra*; *In re Folliard supra* (where officer was personally liable fo breach of trust); *United States v. Weinstein* 834 F.2d 1454 (9th Cir. 1987) (tickets tha were sold without remitting payment to credi tor were deemed to fit into the category o "goods, wares [or] merchandise... stolen, converted or taken by fraud."). See also, *Airline Reporting Corp. v. ATI Travel, Inc.*, No. 98-1511-A (E.D.Va. 1998) (order denying motion seeking dismissal of conversion and fraud claims against travel agent).

Under Virginia law, an officer or director may be held liable for conversion when a corporation holds property in trust and fails to properly account for it. *Cook v. 1031 Exchange, supra.* Liability of corporate officers extends not only to tortious acts in which he participates, but also those tortious acts he brings about. *In re Pontier, supra.* See also, *Michie's Jurisprudence*, "Corporations" §191 (1999); *Restatement (Second) of Agency* §343; see also, *Lopresti v. Terwilliger, supra* (applying New York law); *Dixon v. Texas, supra* (applying Texas law).

For example, in *In re Bishop, supra*, the court concluded that the officer's entering into and facilitating an agreement with a third party, that by its terms violated the trust agreement that the same officer had authorized between his company and a creditor, gave rise to liability for conversion of property at the hands of the third party. Likewise, a bankruptcy court in Virginia found that where the sole officer of a corporate travel agency created a lay-away plan and permitted employees to issue tickets without collecting payment, all in violation of the underlying agreement, the officer would be non-dischargeably liable. *In re Hashemizadeh*, AP No. 97-1266 (E.D.Va. Oct. 27, 1999). Finally, in *Airlines Reporting Corp. v. Inter Transit Travel, supra*, the court held an officer liable

where the liability accrued from failing to notify the creditor of a change in ownership of the officer's corporation as required by the underlying contract.

Once conversion of property is demonstrated, "the plaintiff is entitled to recover, irrespective of good or bad faith, care or negligence, knowledge or ignorance." *Cook v. 1031 Exchange, supra,* 29 Va.Cir. at 304; *Universal C.I.T. Credit Corp. v. Kaplan,* 198 Va. 67, 76, 92 S.E.2d 359 (1956). As Judge Ellis concluded in *Airlines Reporting Corp. v. Pishvaian*: "Had defendant dealt in a similarly direct fashion with the ticket stock, as he did with the tickets sales proceeds, say by issuing or specifically authorizing the issuance of the ticket stock in a manner contrary to the [underlying contract], he would have been liable for conversion of such ticket stock because his conduct would constitute a wrongful exercise of dominion over the ticket stock. And this would be so even though defendant lacked knowledge of the conversion and believed in good faith that he had the authority to dispose of the ticket stock in that fashion." 155 F.Supp.2d at 667.

Breach of Fiduciary Duty

The law of most states appears to recognize three separate fiduciary duties in these creditor-agent relationships. First, an agent is under fiduciary duty to its principal. Second, under the underlying agreement, the agent is a trustee for the benefit of the contracting party with respect to the ordering, possession, accounting, and remittance of certain specifically identified property. In this respect, a trustee is under a duciary duty to account to his beneficiary. inally, a corporate officer or director is under personal fiduciary duty to his corporation id its creditors to act in a manner consistent ith the corporation's interests and its obligaons to its creditors.

uty to the Principal

trustee or agent is under a fiduciary duty to s beneficiary or principal. *Rowland v. Kable,* 4 Va. 343, 367, 6 S.E.2d 633 (1940). Such a ationship exists "when special confidence s been reposed in one who in equity and od conscience is bound to act in good faith d with due regard for the interests of one osing the confidence." *H-B Ltd. Partnerp v. Wimmer,* 220 Va. 176, 179, 257 S.E.2d) (1979), citing *Horne v. Holley,* 167 Va. 234, , 188 S.E. 169, 172 (1936); see also, *Allen ulty Corp. v. Holbert,* 227 Va. 441, 446, 318 S.E.2d 592 (1984). "One who is entrusted with the business of another cannot be allowed to make that business an object of interest to himself." *Rowland, supra,* 174 Va. at 366. Agency consists of "a fiduciary relationship resulting from one person's manifestation of consent to another person that the other shall act on his behalf and subject to his control, and the other person's manifestation of consent so to act." *Reistroffer v. Person,* 247 Va. 45, 48, 439 S.E.2d 376 (1994); see also, *State Farm Mutual Auto Insurance Co. v. Weisman,* 247 Va. 199, 203, 441 S.E.2d 16 (1994).

Corporate officers are equally liable for the torts they cause by their omissions as well as acts of commission.

When a fiduciary relationship arises, the fiduciary should be aware of his heightened state of responsibility. For example, the fiduciary is responsible for keeping the principal informed about anything that "might affect the principal's decision whether and how to act." *Owen v. Shelton,* 221 Va. 1051, 277 S.E.2d 189, 191 (1981); *Avtec Systems, Inc. v. Peiffer,* 805 F.Supp. 1312, 1321 (E.D.Va. 1992) (a fiduciary has a "duty of utmost good faith and full and fair disclosure of all material facts, as well as an affirmative obligations to employ reasonable care to avoid misleading one with whom he deals").

Duty as Trusteee

The elements necessary to create a trust include: (1) sufficient words to create a trust; (2) a clearly defined trust res; and (3) an intent to create a trust relationship. *Leonard v. Counts,* 221 Va. 582, 588, 272 S.E.2d 190, 194 (1980). Such trusts spring from the agreement of the parties, and all persons who have the capacity to hold and dispose of property can impress a trust upon it. *Fleenor v. Hensley,* 121 Va. 367, 373, 93 S.E. 582, 584 (1917). Through the underlying contract, express agency is created, and the corporation acts as an agent of the client, giving rise to the fiduciary relationship. *In re Ellison,* 265 B.R. 539 (Bankr.S.D.W.Va. 1999), *aff'd,* 2001 U.S.Dist.LEXIS 20211. Courts applying the law of Florida and Puerto Rico to similar facts have recognized this relationship. *Airlines Reporting Corp. v. Incentive Internationale Travel, Inc.,* 566 So.2d 1377, 1379 (Fla.App. 1990) (creditor contract creates a principal-agent relationship, which is one "based upon the trust and confidence of the principal in the agent"); *Forastieri v. Eastern Air Lines, supra,* 1983 U.S.Dist.LEXIS 15698, at *11 (analogous contract created principal-agent relationship that was "*prima facie* fiduciary," as is the case when one sells the property of another). And courts in New York and Texas have applied this to other kinds of fiduciary accounts. *Lopresti v. Terwilliger, supra* (ERISA funds held in trust); *Dixon v. Texas, supra* (sales tax proceeds held in trust).

Duty to Others

An increasingly recognized fiduciary duty arises between corporate officers and their corporation's creditors. In *American Honda Finance v. Francis, supra,* the Virginia federal district court found that the bankruptcy court had erred as a matter of law by not recognizing a fiduciary relationship based on the debtor's status as president and chief operating officer of the company. 1993 U.S.Dist.LEXIS 442, at * 8. The court stated "[i]t is well established that corporate officers occupy a fiduciary relationship to... [the corporation's] creditors." *Id.* Likewise, the *Ellison* court held that as a matter of law, the failure of corporate officers to properly account for the proceeds of a trust for the benefit of their corporation's creditor constituted defalcation while acting in a fiduciary capacity. *In re Ellison, supra.*

Conclusion

Obviously, given the case law discussed above, there is ample support in many instances to litigate the issue of officer involvement of what would otherwise appear to be a business loss. And, given the increasing complexity of commercial agreements, particularly those that rely upon the accuracy of financial reporting or the disposition of assets in which a creditor has taken security, one may reasonably expect that the individual officers tasked with fulfilling the corporation's responsibilities will come under closer scrutiny. One should not fear, however, that this liability is unfettered.

Practical experience has taught that whether an officer will be held personally liable is still a largely factual, rather than legal, question. While the case law discussed above provides a

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Internet privacy may not be as prominent as it was a year or so ago, the risk of enforcement actions or private lawsuits does not seem to have declined. Instead, the risk actually appears to have increased and will likely continue to increase in the months and years ahead. Accordingly, when developing privacy policies, efforts must be directed towards ensuring that such policies are accurate, implemented correctly, and supported by sufficient training and continued monitoring of the legal and regulatory environment. FD

Software Contracts, from page 40

ment? In the case of shrink-wrap agreements, it is easy to determine because the package was opened, and there is physical evidence, *i.e.*, the software is out of the box. But even in that scenario, the software provider must prove that the shrink-wrap agreement was in every box. If the defendant contends that the agreement was missing from the particular box it received, the whole issue of the software supplier's quality control and inspection processes will come into play because it is unlikely that the software provider will have actual knowledge about a particular box of software. Defense counsel always should investigate to make sure that the agreement was in fact contained in the box rather than just conceding that point.

When dealing with click-wrap or browse-wrap agreements, if the defendant denies agreeing to the terms of the agreement it is much more difficult to prove that someone actually gave her assent. Clicking on the appropriate spot on a computer screen may create a "signature" but that signature is electronic. The software developer will have to present testimony that the software is designed to end the installation process in the event the user does not accept the terms of the license agreement. However, instances have occurred where clicking the button that denies assent to the license agreement still allows installation of the software to proceed. The integrity and infallibility of that aspect of the program will be at issue. Defense counsel should consider the possibility that the software could be installed even if the defendant did not agree to the terms of the agreement. An expert should be consulted to evaluate the infallibility of the software and whether the fact of installation proves that the assent was given.

The software developer's other evidence will be the software source code data itself, which the developer may contend reflects that the defendant clicked on "Yes" in response to the prompt for its assent to the terms of the agreement. Obviously, it will require expert testimony on the part of the software developer to interpret the source code data and explain the implications to the data of clicking "Yes" or "No" in response to the prompt.

The software developer is probably the only party in a position to interpret its proprietary source code data. Defense counsel should consider seeking that underlying source code data as well as all other information necessary to interpret that data so that the defense expert is in a position to evaluate the accuracy of the developer's position. The threat that the developer will have to disclose its proprietary design information may in itself lead to a resolution of click-wrap and browse-wrap disputes.

Conclusion

While most courts continue to struggle to apply provisions of common law contract law and UCC Article 2 to the various forms of End User License Agreements, a movement is afoot, as reflected in the UCITA, to conceptually change the formation process of contracts to fit the needs of parties to modern software licenses. The present state of disarray in judicial interpretations of the law as it applies to these agreements creates an element of uncertainty for all parties. Until these issues are resolved with some uniformity, they will continue to challenge attorneys, whether they are negotiating contracts or litigating breaches of those agreements. FD

Personal Liability of Officers, from page 47

road map to liability, our experience suggests that to overcome the latent sense of the corporate shield, the court or jury must want to believe that the individual before them should be liable. Elements bearing upon this determination of culpability include: the officer's specific responsibilities as set forth in the underlying corporate documents, internal memoranda, and agreements; an analysis of whether the officer acted in a reasonable manner, consistent with her responsibilities to the business and its creditors; whether the officer profited from the situation (note that while personal gain is not a requirement of liability, it is damning from the perspective of most fact finders); and, whether the corporation truly acted as a separate business, rather than as an extension of the officer. As to this final point, experience suggests that while a court may not reach the high standard of piercing the corporate veil, the appearance of merging one's interests with the corporation's will go a long way to satisfying the fact finder's sense of justice in holding the officer personally responsible for the losses. FD

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